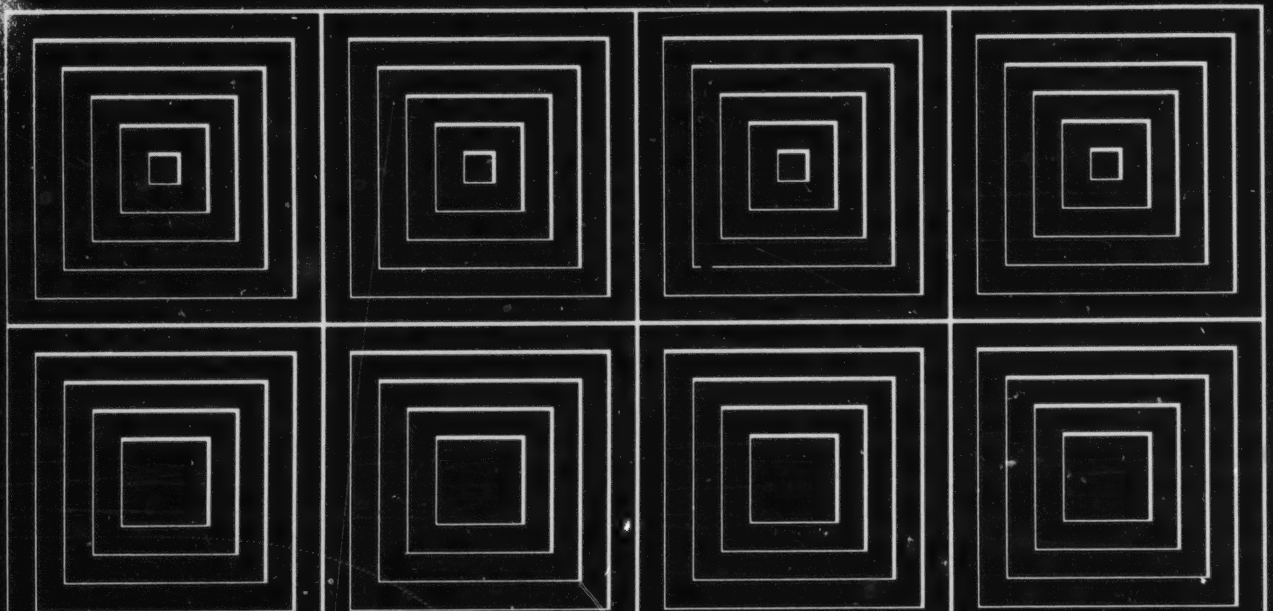
Report of the

Auditor General of Canada

to the House of Commons



Fiscal Year Ended 31 March 1986

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Auditor General of Canada
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AUDITOR GENERAL OF CANADA
VÉRIFICATEUR GÉNÉRAL DU CANADA

To The Honourable the Speaker of the House of Commons:

I have the honour to transmit herewith my Report to the House of Commons for the fiscal year ended 31 March 1986, to be laid before the House in accordance with the provisions of section 7(3) of the Auditor General Act, S.C. 1976-77, c. 34.

Kenneth M. Dye, F.C.A.
Auditor General of Canada

OTTAWA, 21 October 1986

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INTRODUCTION

REPORT OF THE AUDITOR GENERAL

TO THE HOUSE OF COMMONS

FOR THE FISCAL YEAR ENDED 31 MARCH 1986

INTRODUCTION

The principal functions and responsibilities of the Auditor General of Canada are set out in the Auditor General Act, S.C. 1976-77, c. 34, which came into force 1 August 1977. My responsibilities in respect to those Crown corporations for which I have been appointed auditor are set out in the Financial Administration Act, R.S.C. 1970, c. F-10 (amended). The Auditor General Act is included as Appendix A to this Report and the relevant sections of the Financial Administration Act as Appendix B.

The financial statements of the Government of Canada for the fiscal year ended 31 March 1986, which have been prepared by the Receiver General for Canada in accordance with the provisions of section 55 of the Financial Administration Act and appear in Volume I of the Public Accounts of Canada, have been examined by me as required by section 6 of the Auditor General Act.

In compliance with section 7 of the Auditor General Act, my Report for the fiscal year ended 31 March 1986 is presented herewith.

My examination included general reviews of the accounting procedures and such tests of accounting records and other supporting evidence as were considered necessary in the circumstances. With the exception of the audit of the acquisition of Petrofina Canada Inc., departments and agencies and the Privy Council Office provided my Office with all the information and explanations required to date, including cabinet documents. However, from time to time my officers encountered significant delays in obtaining information.

My examination of the acquisition of Petrofina Canada Inc. by the Government of Canada remains incomplete. On 27 December 1985 the Government issued an Order in Council directing the officers of Petro-Canada to provide me with information relating to the acquisition of Petrofina Canada Inc., except for cabinet documents.

I asked the officers of Petro-Canada to provide me with the information. They replied that they had already provided me with all the information they had except that contained in cabinet documents.

I have indicated to these officers and to the Government that I have not received the information I required to enable me to report to Parliament on whether the expenditure of over $1.7 billion of public funds to purchase Petrofina Canada Inc. was made as authorized by Parliament and with due regard for economy and efficiency.

The denial of access to information is the subject matter of a decision of the Trial Division of the Federal Court of Canada. This decision found that the Auditor General is entitled to access to information, including cabinet documents that he considers necessary to fulfil his responsibilities under the Auditor General Act. However, the decision is now subject to an appeal undertaken by the Government to the Federal Court of Appeal.

MATTERS OF SPECIAL IMPORTANCE AND INTEREST

MATTERS OF SPECIAL IMPORTANCE AND INTEREST

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1

MATTERS OF SPECIAL IMPORTANCE AND INTEREST

Spending Public Money Wisely

1.1 This is my sixth annual Report, which means that I am past the mid-point of my 10-year term as Auditor General of Canada.

1.2 One of my continuing objectives has been to encourage a greater sense of thrift in all that have the responsibility of spending taxpayers' money. I hope that the time will come soon when all public servants – elected and non-elected – will spend public dollars with the same care and common sense that wise Canadians bring to spending their own dollars.

1.3 The factors that support that objective, and the identification of things that work against achieving that sense of thrift, form the theme of this chapter.

1.4 There are signs of hope. In March 1986, the Ministerial Task Force on Program Review presented its extensive report. Created in September 1984, the Task Force's mandate was to produce an inventory of government programs, with special concern for identifying duplication, waste and inefficiencies. The tone of the report is established in its opening sentence: "Canadians have a right to expect government that serves their needs at a reasonable cost".

1.5 That precisely reflects my own view. It also echoes the mandate of the Auditor General to draw to the attention of the House of Commons those instances where "money has been expended without due regard to economy or efficiency". However, there are two important differences between the work of the Task Force and the work of my Office.

1.6 First, the approach of the Task Force was indeed a 'review' – a sweeping survey of most of the major programs of the federal government. My mandate – while including review – is to 'audit'. This implies a more detailed and in-depth examination of specific programs. In saying that, I do not intend at all to depreciate the work of the Task Force. Its members achieved a great deal in a very short time.

1.7 The second difference is that the Task Force directly examined the political viability and worth of programs. Our audits stop short of that.

1.8 I can illustrate what this means by referring to Chapter 13 of this Report, which provides an account of our comprehensive audit of the Veterans Affairs Portfolio. The audit reveals a number of problems in the Portfolio that are attributable, at least in part, to the relocation of its headquarters operations from the National Capital Region to Charlottetown, Prince Edward Island. Our audit can and does comment on those problems. But it would not express an opinion on the actual decision to relocate; that decision was made by the

Government and Parliament. The Task Force on Program Review had no such limitation. It reported on policy in a way that my reports do not.

1.9 Another sign of hope that those responsible for spending taxpayers' dollars are doing so more carefully lies in the increased emphasis on a need for restraint in public expenditure. I am not endorsing a particular political program or policy. But I was particularly pleased to receive the February 1986 memorandum on Tighter Resource Management to all deputy ministers and heads of agencies from the Clerk of the Privy Council and the Secretary of the Treasury Board with its message that "we need to modify our 'corporate culture' by re-orienting it toward saving rather than spending". The memorandum goes on to promise recognition for "those managers and departments who achieve their program objectives within budgets. Expenditure lapses in future will be a mark of honour". That kind of thinking is very much in accord with the suggestions contained in an important chapter of my 1983 Report entitled "Constraints to Productive Management in the Public Service", which concluded that "if a deliberate effort were made to establish an environment that encourages managers to achieve satisfactory results at reasonable cost, significant improvements could be made in achieving value for money". I am therefore very pleased to see policy in line with that view of things. I return to this theme in more detail at the close of this chapter.

1.10 Related to this positive initiative is the recent decision to give increased authority to departments and agencies. Approved in principle by Cabinet the objective of the revised approach is to enhance productive management in government by giving ministers and their departments more flexibility in using resources. Together with this increased authority, departments will be required to develop strengthened internal control processes and accountability procedures.

1.11 This decentralized approach represents as much a change in philosophy as it does a change in policies and practices. Treasury Board will be working with departments to ensure an evolutionary transition to this new responsibility and accountability model; the change-over will take a number of years. I will be watching its implementation in departments with great interest. The new approach seems to me a good sign of an imaginative initiative being brought to the whole area of spending taxpayers' money with increased prudence.

1.12 A further initiative with important potential was the Deputy Prime Minister's June 1986 announcement of the Study of Accountability, with the objective of improving the system of management accountability and responsibility in the Government of Canada. Staffed from both the private and public sectors, the Study's objectives will be to review the essential elements of the concept of accountability, to examine existing accountability practices in the government and to make recommendations toward improved accountability. I welcome the study as another significant initiative in achieving more productive management in government.

1.13 Meanwhile, specific improvements do take place.

1.14 I am frequently asked how it is possible for a litany of problems to continue to exist and be reported each year in our audits. I have remarked before that this often overall negative impression given by my annual Reports can be deceptive. It is the nature of an audit report to focus on the things that need improvement. This is intensified by this Office's specific mandate which is to report to the House of Commons those cases where economies and efficiencies have not been achieved. I recognize that one result of our audit approach is, in words spoken to me by a senior departmental official: "You use three lines to say that a program appears to have no problems and then write thirty pages to describe another program that has problems".

1.15 That can be true. I therefore emphasize to readers that they should give special weight to those observations that are positive; for while briefly stated, they do indeed balance - if not outweigh - negative observations which, of necessity, must be described in full.

1.16 I also draw attention to Chapter 15 which provides information on the actions taken by departments and agencies in response to this Office's recommendations in previous Reports; in particular, to eight chapters in my 1984 Report.

1.17 With one notable exception, the results are encouraging. The chapter states that "in most instances, positive actions have been taken or are under way in response to the major recommendations." This overall conclusion is reflected in our individual follow-up assessments:

1.18 In Cash Management:

> The government has now given cash management a high priority and has addressed all the recommendations we made in this area in 1984. The Office of the Comptroller General has made good progress in establishing good management practices.

1.19 And Job Classification:

> In our view, Treasury Board and its Secretariat have taken strong and direct action to address the problems identified in our 1984 audit of job classification.

1.20 In the Canadian International Development Agency (CIDA):

> CIDA has made a serious effort to address the recommendations resulting from the 1984 comprehensive audit and has made significant progress in most cases.

1.21 On the National Energy Board:

> The Board's efforts to address our recommendations have been tangible and realistic.

1.22 In the Department of National Defence:

The Department has moved agressively in addressing the recommendations. Of the 37 recommendations (8 from the Public Accounts Committee and 29 from our Office) requiring a change in management systems or practices, action is reported as complete on 15; another 2 are awaiting final approval. Eighteen are being addressed, while another two are inactive until other decisions are made.

Our preliminary review of progress has led us to conclude that, in most cases, the response by DND has been thorough and properly directed to addressing the factors that led to a need for change.

1.23 And the Department of Public Works:

We found that all our recommendations had received serious study, and a total of 64 action plans had been developed by the Department to address the Auditor General's and PAC's observations and recommendations.

1.24 As to Program Evaluation:

Based on our audit experience, it is our opinion that, since 1983, there has been an improvement in the quality of study methodology and reporting program evaluations.

1.25 The exception is the National Museums of Canada, where we report that "although some progress has been made, important problems still exist."

1.26 I believe that Members of Parliament and the taxpayers of Canada should be heartened by the genuine improvements. I initiated the concept of a follow-up chapter only last year. It is proving a useful vehicle for monitoring these examples of solid progress achieved by departments and agencies.

1.27 Another significant advance is also promised by an initiative of this Office. I refer to our Federal Government Reporting Study.

Federal Government Reporting Study

1.28 This year my Office and the United States General Accounting Office completed our Federal Government Reporting Study (FGRS).

1.29 The starting point for FGRS was the concern expressed in my Opinion and Observations on the government's financial statements, contained in the 1983 Public Accounts of Canada. I discussed the issue further in my 1983 annual Report. My viewpoint was and still is that the government's financial statements should report information in accordance with its essential nature and substance, and that the government should select accounting principles that would permit information to be reported in this manner. I also called attention to certain of the government's accounting policies that I considered inappropriate because they resulted in fragmented reporting of government activities, assets reported at amounts in excess of their value, and unrecorded liabilities. I should add that in the years since 1983, action has been taken to resolve some of these issues.

1.30 This issue of the integrity and usefulness of the summary financial statements has wide and diverse consequences. Those in the federal government with responsibility for establishing fiscal priorities, including Members of Parliament who debate and vote on expenditures and programs, need to know, for example, the full nature and extent of previous commitments. Not only MPs but economists, bankers and advisers at all levels of government in our country require financial statements that fully present significant information on the real extent of the government's revenues, spending, deficit, financial requirements and debt.

1.31 In terms of my theme for this chapter that those responsible for spending public money should do so with care, there exists a clear need that they know and understand the full consequences of their actions. This applies to Members of Parliament as they perform their legislative function. It also applies to government planners and managers as they seek the best options for government spending and exercise their stewardship of federal resources.

1.32 The focus of FGRS rests on my conviction that the needs of the users of federal government financial information should guide the presentation and extent of government financial reporting. Therefore, the approach of our study was first to identify the users of government financial information, and second to identify and understand these users' activities and information needs, as the starting point for building consensus about the form and content of the government's financial reports and statements.

1.33 The products of our work were the Summary Report and Illustrative Annual Financial Reports for Canada and the United States, published in March 1986, and the Detailed Report, published in August 1986, by the Office of the Auditor General of Canada and the United States General Accounting Office.

1.34 Key to my discussion here are the needs of legislative users and of government planners and managers. In the course of our study, Members of Parliament expressed a strong desire for summary-level information that will allow them to see trends in key financial indicators, such as level of debt and spending in relation to Gross Domestic Product, and to obtain a broad perspective on a policy or program issue. Their need is for a clear picture of the financial affairs of the government to facilitate their tasks of exacting accountability and evaluating the financial effects of government actions on society. Members need both summary-level financial information, as background for their consideration of policy proposals, and detailed information, to help them assess the likely costs and benefits of the proposals. They would be assisted greatly by having available an Annual Financial Report as a source of consistent and comprehensive summary financial data and as a reference document to direct them to sources of more detailed and complete information. Members stated that they would have much more confidence in the reliability of such detailed data if they could be related and linked easily to the audited information in an annual summary-level financial report. An Annual Financial Report should therefore be thought of as a basic working tool for Members.

1.35 In fact, one significant product of our completed study is the Canadian Illustrative Annual Financial Report that demonstrates one way of meeting the needs of Members of Parliament, providing them not only with a clear understanding of the nature and extent of Canada's assets, liabilities, financial requirements, deficit and debt, but also pointing the way to the more detailed information they need as they make their decisions. I believe that an Annual Financial Report along the lines of the Illustration should become an official document tabled by the President of the Treasury Board. It could be a revision of Volume I of the Public Accounts or – as I would prefer to see – a new official financial report.

1.36 If Members of Parliament are to fulfil their twin functions of approving proposed expenditures and holding the government accountable, thus playing the vital role of ensuring that public money is spent as wisely and effectively as possible, they must be provided with the tools to do the job. At the June 1986 meeting of the Public Accounts Committee where our study was discussed, the Chairperson of the Committee emphasized this point in giving strong support to our FGRS initiative:

> From the point of view of a Member of Parliament who is trying to track the tax dollar, the present situation is not easy. Granted, many of us are coming as lay people, most of us not accountants, and that the numbers are big and the programs are big. But that said, if you just start from the first information we get and look at how difficult it is to go right down the chain of information and make a comparison I think you will have to agree it is difficult.... The present system really is complex and difficult. I think it is important that the system be simplified so that Members of Parliament can do the job people elected us to do, which is to know what is happening to the tax dollar.

1.37 Government planners and managers also need clear and useful financial information. More specifically, officials with government-wide responsibilities could use the proposed Annual Financial Report to present an overall picture of the financial health of the government that is not available elsewhere. Such a report would be an ideal means for reporting on managers' stewardship of federal resources and on how government operations were financed. It would also provide managers with a general framework within which to situate their own activities.

1.38 A comprehensive, understandable Annual Financial Report would permit the government to show clearly how it has managed public resources; it would also increase the credibility of government managers in the public eye. Also the very requirement to produce such a comprehensive document consistently would foster more rigorous, disciplined financial management systems and practices throughout all levels in government.

1.39 I hope that after the government studies the results of our FGRS research, it will revise government accounting policies where necessary to allow an audit opinion without reservations, and then prepare and publish an Annual Financial Report that responds to the needs of users.

1.40 This may not take very long to do. The other key players in addition to the Office of the Comptroller General are the Department of Finance and the Public Sector Accounting and Auditing Committee (PSAAC) of the Canadian Institute of Chartered Accountants; the latter is seeking to establish generally accepted accounting principles for Canadian governments.

1.41 Both the Comptroller General's Office and PSAAC were kept closely in touch with the progress of FGRS, and they have provided valuable support and advice. They are examining the key issues identified in the Study. The time is not far away when Canada can have a truly useful Annual Financial Report, providing the very best summary-level financial information.

1.42 FGRS – together with such initiatives as the Ministerial Task Force on Program Review, the Memorandum on Tighter Resource Management: A New Corporate Culture, and the Treasury Board initiative – represents the good news in the battle to spend public money more wisely and more effectively.

1.43 But there is also bad news. Two aspects of bad news are income tax expenditures and a lack of clear objectives.

Tax Expenditures

1.44 In 1984 and 1985 I drew attention to problems that arose when tax expenditures were used to implement policies and programs. Chapter 4 of this Report reviews in detail many of the issues involved when government chooses to employ the tax system as an instrument to pursue policy objectives.

1.45 The review focuses on four issues associated with tax expenditures: the risks associated with using the tax system for delivering programs ; the management of tax expenditures; the use of tax provisions to fund Crown corporations; and the adequacy and quality of information that flows to Parliament on the use of tax expenditures.

1.46 In reading the chapter, the magnitude of tax expenditures must constantly be kept in mind. The figure is an approximation but, based on the 1985 Account of Selective Tax Measures prepared by the Department of Finance, we estimate the annual value of income tax expenditures to be about $28 billion.

1.47 The concept of tax expenditures has been widely discussed in recent years. However, it will do no harm to spell out once more the rationale underlying their use.

1.48 They are a tool used by governments to achieve policy objectives. Instead of directing money to a program area, a government – which also has taxing authority – will choose to forego taxes that would ordinarily have become due. Whenever a government grants this kind of tax concession it is in effect providing a subsidy.

1.49 The immense significance of tax expenditures to the whole Canadian economy is that they have become – in the words of the Ministerial Task Force on Program Review – the federal government's "preferred subsidy route during the past decade".

1.50 The tax expenditures that our chapter examines are those relating to income tax; these can be categorized. The first category represents universal modifications of the total income tax system, designed to make it fairer. An example is the age exemption. I have no trouble with these. The inherent risk to public money is not high and the fact and appearance of tax equity seem to be maintained.

1.51 My concerns, as an auditor, relate to tax expenditures in a second category. These are the selective tax provisions intended to encourage certain taxpayers or groups of taxpayers to undertake particular courses of action. Examples are the Multiple Unit Residential Building Program or the Scientific Research Tax Credit Program. The problems associated with using the income tax system in this way are many and complex. But there is one fundamental and overriding problem.

1.52 Key to our whole governmental system has been the development of mechanisms whereby Parliament has the final word on how the government spends public money. The principal elements are control of taxation, control of where and how expenditures are to be made, an audit of accounts, and eventual scrutiny by the Public Accounts Committee. The employment of tax expenditures, as our chapter illustrates, at present effectively erodes these controls.

1.53 The complexity of government today and its impact on the economy as a whole have meant that much work, imagination and effort have been devoted to ensuring that control and accountability procedures are in place to determine how, where, why and how well public money has been spent in terms of direct expenditures. This Office plays a key role in finding out whether those procedures exist and are doing their job. At the present time the use of tax expenditures bypasses many of these controls and procedures. It is as though we had been attending to other wounds while the life blood has been flowing from severed arteries.

1.54 This failure of control and accountability in the use of tax expenditures is the result of a variety of factors spelled out in detail in Chapter 4. This overall failure spins off a number of associated problems that the chapter discusses as well.

1.55 Four of these factors and problems are of such great significance that I am bringing them to the attention of the House of Commons in this chapter which concerns matters of special importance and interest.

1.56 First, as Chapter 4 makes abundantly clear, the high-risk nature of the tax system as a program delivery mode demands that all such programs be subjected to procedures that recognize and respond to those risks. However, it is important to realize that while good procedures may contain such risks, they will not eliminate them. A measure of risk is inherent whenever the income tax system is employed to deliver programs.

1.57 Second, this use of the Income Tax Act to fund programs can have a dangerous impact on the integrity of the tax system. Maintaining integrity is essential for the survival of a tax system that relies in large measure on self-assessment. In using the Income Tax Act to attain desired economic or social objectives, it is often necessary to sacrifice equity. Thus, the failure to evaluate tax programs in terms of a potential loss of equity is a dangerous path to follow. But the issue does not stop there. To attempt to prevent taxpayers from using the tax breaks in ways that although they are legal were not contemplated or intended by Parliament, requires changes in the Income Tax Act that make it increasingly detailed and complex.

1.58 Nonetheless, it is almost impossible to eliminate this kind of tax avoidance. What emerges is a complex defence by officials in the Departments of Finance and National Revenue - Taxation of the original intent of the tax funded program against the encroachment of high-priced advisers and experts who seek to broaden the tax avoidance opportunities presented to them. In nearly every way it is an unproductive conflict, over-complicating the tax system and creating a widespread and growing perception by those taxpayers that do not have access to expert advice that they are being denied equity, fairness and the opportunities available to the well-to-do.

1.59 Unless this situation can be corrected, it has the potential to take Canada's Income Tax Act down that slippery slope to the point where tax avoidance, which is sanctioned (except where it conflicts with tax avoidance rules), becomes confused with tax evasion. Tax evasion is not legal.

1.60 Third, this questioning of the integrity, fairness and credibility of the tax system is given further stimulus by retroactive tax legislation that was designed to benefit a single entity. This seems to have been the case with the tax changes that potentially benefit Dome Petroleum in its acquisition of Hudson's Bay Oil and Gas Company Limited.

1.61 Fourth, both in relation to what I have just said but also in the wider perspective of all the documentation available to MPs, the information that Parliament receives about tax-expenditure-funded programs is deficient. The Fiscal Plan does not reveal the intended re-allocation of financial resources when the re-allocation is to be accomplished through the tax system. The Estimates do not disclose the planned extent of the government's spending when the tax expenditure route is to be used. The Public Accounts, which are supposed to set out the completed financial transactions of the government, do not disclose the full extent of tax expenditures.

1.62 Parliament is therefore being foiled and frustrated in its twin tasks of approving proposed expenditures and holding the government accountable.

1.63 Appendix C to this Report includes the Fourteenth Report to Parliament of the Standing Committee on Public Accounts, which deals with the Committee's hearing on my 1984 audit observations relating to the Scientific Research Tax Credit.

1.64 The Committee's recommendations are so pertinent to our broader scrutiny of the use of tax expenditures that I want to include them here:

> Your Committee recommends that the Government avoid the use of pre-funding in tax expenditure programs.
>
> Your Committee recommends that in future the Minister of Finance table in Parliament a document outlining the results of any consultation process involving proposed tax expenditures prior to the passage of legislation giving effect to the tax expenditure in question.
>
> Your Committee recommends that in future the Minister of Finance report to Parliament any changes in the interpretation of tax expenditure legislation.
>
> Your Committee deplores the fact that the Department of Finance did not have adequate controls in place and recommends urgent action to ensure that adequate controls are in place in order to safeguard public funds in any future tax expenditure program.
>
> Your Committee recommends that the Minister of Finance:
>
> - table an annual report stating the objectives, known information on progress towards these objectives, and estimated costs of every major tax expenditure program; and
> - develop a mechanism to alter quickly a tax expenditure program where significant problems have been encountered.
>
> Your Committee recommends that the Department:
>
> - develop a comprehensive program evaluation capability, as described in the Comptroller General's "Guide to the Program Evaluation Function"; and
> - ensure that all tax expenditure programs are subject to program evaluation.

1.65 In underlining the importance of those specific recommendations, I suggest that our wider review this year of the whole issue of using tax expenditures to fund programs reveals the dimension of risk attached to their use.

1.66 It may be that the income tax system is an appropriate mechanism for delivering certain broad-based programs. However, the thrust of our review is that the use of the income tax system to deliver several more narrowly focused programs has involved a very high risk to the public purse. While I applaud the government for recognizing and seeking to contain these risks, it remains essential that Members of Parliament, as ultimate guardians of the taxpayers' dollars, should have complete and timely information as to the extent of that risk in relation to specific programs.

1.67 It is also essential that those who have the responsibility for deciding on the funding of programs should, at the program proposal stage, perform a review of alternative delivery modes if obtaining value for money is to play its proper role in the choice of instrument.

1.68 Some of Canada's experience with tax expenditures has been pretty sad. As Parliament's auditor, I cannot emphasize enough that the Income Tax Act is a high-risk statute to use for delivering programs unless proper procedures are in place. Failure to act in a timely manner to eliminate identified avoidance mechanisms has resulted in hundreds of millions of dollars of revenue losses. The potential for the same kind of thing to happen again continues to exist. Because of their magnitude, this latent lack of control in the use of tax expenditures may well represent one of the most serious voids in parliamentary control over the public purse in Canadian history.

A Need to Define Objectives Clearly

1.69 An issue that I discussed in last year's annual Report resurfaces in some of this year's chapters. In 1985 I wrote that it is often unclear why certain programs are undertaken and that, if the objectives for a particular program are unclear, it is difficult for the Public Accounts Committee to judge whether value for money had been attained in achieving those objectives.

1.70 It would be naive not to recognize that behind that observation lies a great deal of Canada's economic experience. Governments have always attempted to achieve social goals in conjunction with other priorities.

1.71 These attempts are one component of what the Task Force on Program Review refers to as "the universal subsidy" that governments have used "to equalize between the 'haves' and the 'have-nots', to support failing enterprises, to provide essential services and to encourage certain economic or social behaviour".

1.72 The decisions that lie behind governments' support of such programs are policy decisions. And I do not question them. Indeed there exists a strong body of opinion in our country that says that it is logical and compassionate to try to achieve social goals while at the same time pursuing other economic objectives. In its broadest perspective, this mingling of aims may be illustrated from two chapters of this Report.

1.73 Chapter 8 reports our comprehensive audit in the Department of Agriculture. As our audit clearly recognizes, the mandate of the Department is complex. With a legislative base of some 40 Acts of Parliament and playing a major role in ensuring not only that our own country's consumers can buy agricultural products at a reasonable cost but also that Canada's agricultural exports of over $10 billion remain competitive, the Department is confronted by a spectrum of immediate, inescapable imperatives. Many Canadian farmers face seemingly insurmountable financial problems. Internationally, there exists what amounts to a trade war in agricultural products. Soil degradation is said to cost Canada about $1 billion a year. Meanwhile, agricultural, food and associated sectors of our economy provide employment for one and a half million Canadians.

1.74 It therefore becomes abundantly clear that each of the Department's programs must take into account a complex variety of objectives and consequences. It is a daunting task. And when our auditors examine whether those programs have been managed with due regard for economy and efficiency, we must make ourselves aware of the complexity of objectives and related consequences.

1.75 Chapter 10, which reports our auditing in the Department of Fisheries and Oceans, presents a similar state of affairs. Our audit this year concentrates on the Pacific fishery. The objective of the audit was to examine how the Department manages the fishery at the point where critical fish management decisions are made – "where the nets hit the water".

1.76 Now, if the mandate of the Department were merely to ensure that each fish was caught and marketed at the lowest possible cost while also ensuring that this naturally replenishing resource was not being depleted, its task would be pretty straightforward. However, reality is far more complex. Fierce competition exists between commercial and recreational fishing interests. Further, native people have traditional fishing rights. Modern technology has contributed to an over-capacity in the fishing fleet, at a time of high debts and uncertain incomes for many for whom fishing is a way of life.

1.77 It all means that any decision is fraught with economic and social consequences that extend far beyond simply harvesting a renewable resource as efficiently and economically as possible. And, once again, our audit takes these factors into account as it seeks to inform Parliament of the problems faced by the Department.

1.78 The Task Force on Program Review chooses to criticize this concept of using, say, agricultural programs or fisheries programs to promote 'social' activities, targeting it as one component of that 'universal subsidy'. Others, taking a contrary view, may believe that this blending of program objectives is what Canada is all about. The Task Force likens the Canadian economy to "Gulliver, tied down by a (myriad) Lilliputian subsidy ropes... each infinitesimally thin, yet together immobilizing". Others would argue that those ropes are the threads that create the fabric of our country.

1.79 These realities result in two difficulties for an auditor. The first is unavoidable. It is, as I have already said, the constant need to be aware that many programs have more than one objective, and the associated need to relate all value-for-money considerations to the varied, complex and often conflicting objectives of a single program.

1.80 However, the second difficulty should not exist. It occurs when the objectives for a specific program are ill-defined. The very fact that many projects have multiple goals demands that those that have responsibility for stating the purposes of particular undertakings should ensure that those purposes are clearly defined. Otherwise, it is impossible for Parliament or the auditor to establish whether there has been appropriate care given to achieving value for money.

1.81 The Capital Projects section of Chapter 14 discusses the construction by Public Works Canada of the Guy Favreau Complex in downtown Montreal. Dating back in concept to 1966, when a decision was made to provide a single office complex for federal government employees working in the Montreal core area, the plan for the complex became almost a case study in changed and changing objectives. By 1976, the goal had become to establish a strong federal presence in Montreal. And through two decades – largely, it appears, because of the tension between the original pragmatic need for office space and the later more overtly political objective – the whole process of design, planning, project definition, options analysis, etc. emerges as a nightmare of escalating costs and of misleading information going to Members of Parliament.

1.82 Other examples of confusing objectives emerge from Chapter 6 which discusses certain programs administered by the Canada Employment and Immigration Commission. Consider the Employment Creation Grants and Contributions program (ECGC) set up in 1982. The program was designed to channel funds into direct job creation for the unemployed through local projects. For the auditor ECGC has several troubling features.

1.83 First, the eligibility criteria for projects were too broad, opening the door to approval of virtually any project.

1.84 A second feature that violated good accountability procedures was that hardly any safeguards were provided to ensure that the program would achieve its primary objectives. CEIC's role was limited to that of an intermediary; it had no decision-making authority about the quality of projects approved. Ministers and Members of Parliament played the dominant role in the selection process. This caused projects to be announced publicly before they were assessed by departmental officials and projects to be approved that showed little regard to economy or effectiveness in creating jobs for the unemployed.

1.85 A third element in the program was that projects could be funded either by grants or by contributions. An essential difference between the two is that contributions are subject to monitoring and audit; grants are not. Ninety-six percent of the funds were distributed in the form of grants. In permitting the grants route when capital projects were involved, Treasury Board was creating exceptions to its own preferred policies.

1.86 Given all these things, it will come as no surprise that the Employment Creation Grants and Contributions program has achieved precious little in the way of creating genuine employment; nor that, with all its wide open features, the program appears to be, for all intents and purposes, an instrument for directing funds to regions of Canada favoured by particular political interests.

1.87 A further illustration of the extra cost incurred when objectives, other than program objectives, dominate the decision making, is discussed in Chapter 7, which reports our comprehensive audit of the Correctional Service of Canada (CSC). The audit reveals that, in order to provide economic benefits such as increased employment in a depressed area, CSC was required to build institutions at certain locations. To meet these and associated requirements, CSC had to build at a security level higher than one for which a program need existed. The projects involve construction to a Protective Custody level.

1.88 In obtaining Treasury Board approval for one of the projects, CSC did not provide the Board with up-to-date information on the surplus capacity already available at the maximum security level in the region that could be used to meet the accommodation need that the project was intended to fulfil. The Board was therefore not aware of the possibility of using that surplus capacity to fill the need at the Protective Custody level. Thus the information supplied to Treasury Board was not sufficient to enable the Board to make an informed decision with due regard to program needs and to economy.

1.89 The decisions to construct the two Protective Custody institutions have three important effects:

- Since construction at the Protective Custody and maximum security levels costs significantly more than that at the medium security level, CSC has committed itself to unnecessary extra costs. Based on our most conservative estimate, these additional costs will be around $49 million.

- Although an excess capacity is foreseen at the Protective Custody and maximum security levels, there will be a shortage at the medium security level. The excess capacity at the Protective Custody and maximum security levels will be mainly in the eastern regions of Canada, with some shortage in the western regions. The shortage at medium security level will exist in all regions.

- There could be an adverse effect on the achievement of CSC's program objective of preparing inmates for their return to the community.

1.90 I have already said that the fact of there being more than one objective when programs are undertaken does not in itself trouble me. It is a Canadian tradition – a tradition that has many positive dimensions to it. However, it is a tradition that may be readily misused. It appears to me that this may well have been the case with these construction projects.

1.91 The problems that these examples illustrate – of objectives other than program needs overriding program needs – have two far-reaching consequences.

1.92 The first formed the theme of this chapter in my Report last year. It is the question of the appropriateness and quality of the information that Members of Parliament receive; and I have already referred to the same issue in my earlier discussion of our Federal Government Reporting Study. So I won't belabour the point, except to re-emphasize that when inadequate or misleading information is presented to MPs on, say, a major capital project, they are in the dark when they approve the expenditure and they are equally in the dark when they attempt to fulfil their accountability role of determining if public money has been spent properly and wisely.

1.93 The second issue goes to the heart of my theme for this chapter. I can express it this way. The February 1986 memorandum from the Clerk of the Privy Council and the Secretary of the Treasury Board promises recognition to "those managers and departments who manage well, and achieve their program objectives within budgets." It also speaks of the "need to modify our 'corporate culture' by re-orienting it towards saving rather than spending."

1.94 I applaud those sentiments and their aim. However, for that aim to become reality, the new 'corporate culture' must go hand in hand with a new political candour about the true rationale for programs. Public servants are not fools. If, when developing the most cost-effective options for projects or programs, departmental officials are well aware that, in fact, value-for-money considerations will rank well below other priorities when the final decision is made; if, worse, they are aware that the decision to implement a particular program has already been made, and that they are only now being asked to produce an operational requirement document that will match and justify that decision, then public servants can scarcely be blamed for becoming cynical about the total process.

1.95 That memorandum from the Clerk of the Privy Council and the Secretary of the Treasury Board challenges deputy ministers to "engage the full support of all your staff in meeting these goals of expenditure restraint and productive management". On the evidence of the chapters in this Report and in previous Reports, the other side of that coin is that planners and managers in the public service must become convinced that their efforts and proposals to achieve value for money are taken seriously when the real decisions are being made.

1.96 Past events have made public servants sceptical. I cannot say that I blame them for their scepticism.

1.97 In the "Constraints to Productive Management in the Public Service" study that was included in my 1983 Report, the primary finding was that political priorities have a significant impact on productive management:

> The political process has concerns that tend to overshadow and, to some extent, displace productive management... Politicians rarely get elected for concentrating on productive management of departmental operations.

1.98 Our study went on to affirm that "we do not, of course, question the political process", but that a way should be sought to minimize the dilemma for the public servant who is being entreated to achieve value and at the same time to implement programs that are made more costly because, say, regional development objectives must also be met.

1.99 Some way must be found that will permit the fact that many programs have more than one objective to be clearly spelled out. Such openness and clarity would go far to restoring a sense of morale and purpose among public servants, especially at a time when they are being called on to espouse a new corporate culture of tighter resource management.

Accountability and Motivation

1.100 **Achieving accountability**. Two things are essential if public funds are to be spent with common sense and effectiveness. The first is to get a grasp on the true costs of government programs. The second is to encourage elected and non-elected servants of the public to make real this new corporate culture of saving rather than spending.

1.101 Getting a handle on the true costs of government is in large measure what our Federal Government Reporting Study is all about. Should the government introduce the kind of Annual Financial Report that FGRS envisages, it will become necessary for departmental officials to have an extensive grasp of the actual costs of programs in order to develop the numbers for the Annual Financial Report.

1.102 I recognize that it is no easy task for public service managers to become more cost conscious and more accountable for costs. I have already written about the ambiguity of the tasks that departments are frequently asked to perform. Added to that must be the recognition that departments that serve the public receive far more plaudits for getting the job done than they ever will for getting the job done at minimum cost. Traditionally, cost consciousness in public servants has been neither recognized nor rewarded. Further, accountability for costs is made more difficult because in all of government there is fragmentation among budget systems, contracting systems and procurement systems, and between all these systems and the decision-making process itself, which includes an essential political dimension.

1.103 Nonetheless, that some far better system of accounting for costs is necessary can be illustrated time and again from the chapters of this Report.

1.104 Chapter 13 reports our comprehensive audit of Veterans Affairs. My sense is that Parliament, veterans and the general public consider that the Department fulfils its mandate of helping veterans and their families obtain the benefits and services to which they are entitled. But my mandate requires me to ask whether those services are being provided with due regard for economy and efficiency. Our audit reveals that in some cases they are not.

1.105 For example, incorrect War Veterans Allowance payments to veterans have resulted in overpayments far in excess of the $20 million the Department spends in administering the program. A number of cost-effective measures could have been taken to minimize this problem. Some of these measures are now being implemented.

1.106 We also report that the Department spent more than $17 million developing a computer system for use in administering the program. However, promised efficiency improvements were not achieved partly because the system's design did not take advantage of opportunities to improve efficiency.

1.107 Our report on Veterans Affairs uses these words to describe financial management in the Department:

> Our findings have led us to the view that there are serious weaknesses in basic internal controls and that insufficient emphasis and attention appear to have been given to the financial implications of decisions. The effects of this are compounded by the fact that financial management information, though voluminous, is not regarded by managers as useful or reliable.

1.108 Again and again our audits reveal that because there is no real demand for cost accountability, no one is recording or consolidating the total costs of programs. A revealing example involves those publications that government departments produce and distribute free to the public. Such publications can be an effective means of communication. However, our special audit of free publications – reported in Chapter 14 and covering four departments that are much involved in disseminating information – shows that the significant costs of free publications in many cases were not routinely and systematically estimated prior to publishing, or collected afterward. Generally, unless resources were to be contracted from the private sector, the principal cost component used for planning and budgeting purposes was the cost of printing alone.

1.109 But, as our audit goes on to point out, actual printing costs are only one component of a publication. The larger costs are the "hidden" costs of planning, designing, writing, editing, translating, word processing, graphic arts, promotion, distribution and storage. Our audit leads me to conclude that, in a majority of cases, the real costs of producing publications are neither estimated beforehand nor recorded afterward. Needless to say, cost accountability becomes difficult to achieve when program costs are not systematically tracked.

1.110 Our audit of the Pacific Region of the Department of Fisheries and Oceans – Chapter 10 – uses words that summarize my overall concern:

> Under its present planning and budgeting system, the Region is not managing its regional resources to ensure that program requirements are being achieved at reasonable costs.
>
> The underlying reason for the weaknesses in all these areas is that improving the management of resources has not been viewed as a high priority. The major preoccupation of the Region has been responding to the day-to-day pressures involved in managing the fisheries. There has been little emphasis on managing its total resources to achieve agreed upon objectives or results.

1.111 My point is that unless and until improving the management of resources is viewed as a priority throughout government, neither will the incentive exist nor will the necessary machinery be put in place to ensure that programs are delivered at minimum cost.

1.112 **Financial management and control**. An important initiative already under way in my Office is our Financial Management and Control Study. Its findings will be a major feature of my 1987 annual Report. The Study, which will examine financial management and control in a number of departments as well as in the central agencies, will be a follow-up to this Office's review of the same issue 10 years ago, which led to putting in place new financial systems and controls and attempting to strengthen those already in existence. It also resulted in the improvement of the information in the Estimates with the creation of the Part IIIs. In addition, our earlier review was one of the important factors that led the government to establish the Office of the Comptroller General.

1.113 The improved level of accountability in government owes much to these initiatives. However, key questions remain to be answered. Are the decision makers and managers receiving the financial information they need to make good decisions and manage programs cost-effectively? Is the information accurate, complete, timely? Is the information that ministers are receiving from departments – and that MPs are receiving – relevant and timely?

1.114 These and a whole spectrum of related issues are the subject of the Study. There may also exist a tendency in the public sector to assume that the imposition of controls guarantees accountability. But the imposition of largely centralized controls may be counterproductive, consuming line department managers' time and tending to stifle or restrict initiative. Our new Study will be reviewing such issues as well.

1.115 Ultimately, the key to improved value for money in the expenditure of public funds does not lie in improved accountability systems alone but in two elements that are essential in any enterprise. The first is leadership which, in public sector terms, means that there must be the genuine political will to achieve the greatest degree of economy, efficiency and effectiveness. The second is motivation, which implies a genuine commitment by public servants to common objectives and which also means a sense of fulfilment and self-reward in achieving those objectives; but also the certainty that such achievements will receive recognition and material reward.

1.116 However, before discussing those twin issues of leadership and motivation, there are specific items relating to accountability that I wish to address.

1.117 **Appropriation and authority**. Even though we are doing important work with the Federal Government Reporting Study and our examinations of financial management and control, the fundamental financial control remains parliamentary control over the public purse. The results of my Office's audits indicate that this control cannot be taken for granted. During the past 10 years we have reported over 175 instances of failure to comply or questionable compliance with appropriations acts, the Financial Administration Act and its regulations, and other statutes of Parliament. We have reported numerous violations of Treasury Board and Cabinet directives and guidelines as well.

1.118 Parliamentary control over the public purse rests on the bedrock of control over taxation, appropriation of moneys, the Financial Administration Act and legislation enacting government programs. Although individual contraventions of tax, appropriation and other legislation may appear mundane, on a cumulative basis they slowly erode the foundations of parliamentary control over public funds. Ministers and other public servants, like all Canadians, are obliged to obey statutes of Parliament.

1.119 The Financial Administration Act sets out the basic rules and procedures to be followed by public officers, including ministers, who are responsible for public funds. It also requires public officers to report violations of the Act and its regulations to their superiors.

1.120 Parliament has also required that the Auditor General examine and report on the extent of compliance by the government of the day with all these acts. I am required to report to the House of Commons cases where moneys have not been expended as authorized and also where money has been expended for purposes other than appropriated by Parliament.

1.121 To assist Parliament in its scrutiny of whether the government has used public funds as authorized, I have asked my auditors, in the coming years, to intensify their examinations of compliance with appropriations acts and other legislative authority.

1.122 **Problems in a Crown corporation.** This year's Audit Notes chapter – Chapter 3 – tells the story of problems encountered by the Canadian Broadcasting Corporation (CBC) in implementing a complex new financial information system and the resulting inability to maintain proper books of account in 1985-86. The failure to maintain proper books means that management cannot provide a full accounting to the Board of Directors. At the same time, the Corporation cannot provide a reliable account of its financial stewardship of public moneys to the government and, ultimately, to Parliament. The important accountability relationships among senior management, the Board of Directors, the Minister, government and Parliament are endangered when such a situation occurs. I have expressed to the Corporation my serious concerns about public funds being at risk, and I am pleased to be able to report that the Directors and management of the CBC are actively addressing the recovery program.

1.123 **Trust funds and pension plans.** Accountability cuts two ways. The Government of Canada and its servants must be accountable to Canadian taxpayers for the prudent expenditure of public money. However, it has a more specific obligation to ensure that those segments of the population that are, by statute, to be served by the government are properly and correctly served. I noted earlier that some veterans had been overpaid by Veterans Affairs by considerably more than $20 million. But I should also point out that other veterans have been shortchanged to a total of an estimated $3.8 million. This represents a significant failure in accountability to a group of Canadians for whom Parliament and the people of Canada clearly intend a special concern.

1.124 Two chapters this year relate rather similar issues, where the government has a trustee relationship with specific groups and where it may well be that the departments in question are failing to live up to their obligations.

1.125 The first is reported in our comprehensive audit of the Department of Indian Affairs and Northern Development (Chapter 11). The Department has many statutory responsibilities, including administering reserve lands, band funds and the estates of certain individual Indians. The Department thus has the mandate to ensure that Indian lands and estates are managed in accordance with the legislation.

1.126 Even though considerable debate and confusion have surrounded the precise requirements of this mandate over the years, it is clear that the Department has responsibilities and duties analogous to that of a trustee in respect of the Indian people.

1.127 Our audit raises important questions as to how well the Department has fulfilled this obligation. As Parliament's auditor, I have previously brought to the attention of the House of Commons that, in at least one area of this concern, the Crown may face substantial potential liabilities. But in a wider perspective, the whole subject brings to the fore important principles about the government's accountability to citizens to whom it is legally and morally obligated.

1.128 A parallel instance is reported in our audit of Veterans Affairs where the Department manages trust accounts for veterans. Our conclusion is that a trust relationship exists between the Department and administered account clients, but that the Department has not met the minimum obligations of this situation:

> Recipients whose affairs have been administered by the Department have, at best, had the benefit of its good intentions. However, they have been deprived of the investment value of their funds. Those whose affairs have been placed in the hands of third parties may in some instances have had the benefit of some interest on their funds, but at the cost of having their affairs left unsupervised.

1.129 I am pleased to note that the Department is acting quickly in response to these observations. Again, I regard the matter as an important accountability issue in respect of a group of our citizens to whom Canada owes much.

1.130 Another broad-ranging matter for concern is reported in Chapter 12, which discusses our audit in the Department of Insurance. One of the Department's responsibilities is the supervision of federally registered employee pension plans, excluding the government's pension plans. The Department supervises some 750 plans covering 600,000 individuals.

1.131 My concern is in part prompted by the events surrounding the recent failures of banks and other financial institutions in Canada. Our audit reveals that the potential exists for problems similar to those that undermined the banks to affect pension plans. I do not wish to be alarmist but when our audit reveals that, in assessing the financial solvency of pension plans, the Department relies almost entirely on the representations of management, that it carries out few field examinations, that it does not require the annual submission of complete financial statements, that there is a growing trend to withdraw surplus funds to provide cash funds for company operations, and that there are no independent reviews carried out by the Department to assess the underlying value of investments by pension plans in real estate and mortgages, I cannot fail to note the parallels with features of the other failures of financial institutions.

1.132 There will be increasing economic pressure on all pension plans in coming years because of the changing composition of our country's population. The viability of pension plans is of vital importance to Canadians. This is an area where, in its accountability to individuals, the government needs to exercise greater vigilance. We may well have here a time bomb – with a 5, 10 or 20 year fuse – waiting to explode.

1.133 **The fiscal totality.** A fact that comes through strongly from our audits is that the budgetary process in departments seems often to be largely incremental. The Task Force on Program Review wrote of 'the fiscal totality'. Its estimate of this annual totality is:

Tax expenditures	$36 billion (39%)
Statutory expenditures	$37 billion (40%)
Non-statutory expenditures	$20 billion (21%)

And the Task Force went on to point out that:

> Of these categories, only non-statutory expenditures are 'controlled' in the sense that new discretionary expenditures are subject to ministerial scrutiny both in the policy committees of Cabinet and by Treasury Board.

1.134 The particular truth of that observation is apparent to me as I read the reports of this year's audits. Notwithstanding the existence of the program evaluation process and the fact that my Office has the mandate to enquire whether satisfactory procedures have been established to measure and report the effectiveness of programs, the same degree of scrutiny is seldom focused on existing programs as is the case with new initiatives.

1.135 The Annual Financial Report proposed in FGRS would provide ministers, MPs, and government planners and managers with a far better concept of the total expenditures, including tax expenditures, being directed to meet specific policy objectives and programs. However, that information is not sufficient by itself. In my view, there must be put in place some better mechanism to ensure that all existing programs are regularly scrutinized to determine whether they are needed. Without such a mechanism, words like 'accountability' and 'restraint' can have little meaning. Or – which may be worse – governments, in the interest of reducing the deficit, will be obliged to make across-the-board cuts, decimating useful programs along with poor ones.

1.136 As I indicated last year, the Part IIIs of the Estimates should be providing the kind of information that would allow parliamentary committees to make their own judgements on the effectiveness and validity of programs. I will be continuing to review the Part IIIs to ensure that they provide valid insights as to how departments and agencies operate.

1.137 **Motivation and leadership**. There is a growing awareness that improved management in the public sector depends on something more than improving systems.

1.138 Improved accountability systems, reorganization of structures, and even cost-cutting mechanisms are all very well. But management is more than a matter of better processes. Management means producing results. My own conviction, after five years in Ottawa, is that the most effective managers first of all recognize and accept that objectives within the public sector are often ambiguous. But, working within that climate of ambiguity, they nonetheless inspire others to excel. They do so by using effectively the limited incentives that the overall government system allows. They give genuine thought and attention to the people accountable to them in such areas as promotion and training. They create a standard of excellence.

1.139 Canada has a long tradition of attracting excellent people into its public service. That tradition, I believe, continues to hold true. What prevents them being more productive is, more than anything else, the mixed messages they receive. I have touched on this already in my discussion of the continuing need to reconcile political and managerial requirements. I can illustrate the problem in a different context by reference to our government-wide study on year-end spending which we report in Chapter 5. As our study observes:

> There is a perception that the government goes on a spending binge at year end and that millions of dollars are wasted...
>
> We carried out a study with the objective of determining whether there was extra cost to the taxpayer because of spending at year end. We examined a sample of 1984-85 year-end transactions. We found, in general, that year-end expenditures were made on items that were within documented specifications and for which there was a defined need. But we also found instances where expenditures were made in advance of need or before the due date. Based on the results of our sample, we estimated that this spending resulted in an extra cost to the taxpayer of approximately $3 million in storage and foregone interest costs.... Thus, our findings show that, although there is an extra cost to the taxpayer associated with spending at year end, it is of much less dollar magnitude than generally perceived.

1.140 Our examination of year-end spending goes on to make the very important point that the concept of lapsing funds "encourages managers to withhold a portion of discretionary expenditures until late in the fiscal year to retain enough flexibility to deal with unexpected events or needs."

1.141 The study explores the motivation of managers in adopting this approach:

> In the private sector, getting the job done while coming in under budget is rewarded as good management. In the public sector, it appears that this lapsing policy exerts pressure on managers to spend in order to avoid lapsing funds. Thus they perceive that there is an incentive to spend all available funds in the current year to avoid being 'penalized' the next year by having their budgets cut

or being required to absorb spending postponed from a previous year within a budget level that has already been set for the next year.

1.142 What that is saying is that in the widespread perception of government managers, the budgetary process has been sending the signal to 'spend now' rather than 'save'. It is not that public servants have been under-motivated. Indeed, paradoxically, it may well be that those who have spent substantially at the year end have been very powerfully motivated. The problem is that the system has been sending the wrong signals – wrong, that is, for a climate of restraint and in a period of deficit reduction.

1.143 The long-standing messages that the system has traditionally sent to departments and agencies can be changed. The lapsing of funds policy is a basic principle underlying parliamentary control of public money. However, I am pleased to learn that the Office of the Comptroller General is seeking to determine whether improvements can be made that will minimize any incentive to spend funds before the year end just to avoid lapsing.

1.144 I was pleased to see that the February 1986 memorandum from the Clerk of the Privy Council and the Secretary of the Treasury Board directly addressed the need to change the signals that flow to public managers. As this Report goes to press, the promised details of the incentives designed to speed this change from 'spending' to 'saving' have yet to be announced. However, in principle, I strongly support the approach.

1.145 In a climate of restraint, good management – already so basic – becomes all the more important. The essential elements are, first, accountability systems at every level that provide the information that all those involved in spending require in order to deploy public funds at least cost and with greatest effectiveness; second, clear objectives for all programs – and openness whenever programs have a secondary, or even primary, political objective; third, a harnessing of the already existing high motivation of public servants toward saving rather than spending; and finally, a shared conviction by departmental officials, Members of Parliament and the people of Canada that there is an urgent need to achieve value for money and a genuine political will to achieve it.

1.146 Only then will taxpayers' dollars be spent with care and wisdom.

GENERAL SUMMARY

GENERAL SUMMARY - 1986 ANNUAL REPORT

2.1 This chapter contains summaries of most of the chapters in the 1986 Report of the Auditor General to the House of Commons. The summaries are set out in the order in which chapters appear in the Report. Chapter 1, Matters of Special Importance and Interest, Chapter 3, Audit Notes, and Chapter 15, Follow-up of Recommendations in Previous Reports, are not summarized here.

2.2 The summarized chapters in this year's Report are:

Chapter 4 - Income Tax Expenditures
Chapter 5 - Year-end Spending
Chapter 6 - Canada Employment and Immigration Commission
Chapter 7 - Correctional Service of Canada
Chapter 8 - Department of Agriculture
Chapter 9 - Department of External Affairs - Trade Function
Chapter 10 - Department of Fisheries and Oceans
Chapter 11 - Department of Indian Affairs and Northern Development
Chapter 12 - Department of Insurance
Chapter 13 - Veterans Affairs Portfolio
Chapter 14 - Special Audits
  - Capital Projects
  - Free Publications
  - Department of Energy, Mines and Resources - Management of the Public Communications Function
  - Social Sciences and Humanities Research Council
  - Canada Oil and Gas Lands Administration

CHAPTER 4 - INCOME TAX EXPENDITURES

2.3 The income tax system in Canada has two broad objectives – to raise revenue and to serve other economic and social purposes. The second objective involves using the tax system as an instrument or set of instruments to pursue other economic and social purposes. This gives rise to what have come to be known as tax expenditures.

2.4 **The Income Tax Act is a high-risk statute to use for delivering programs.** The inherent risks associated with tax spending are summarized below:

- Program costs are open-ended, so that if more taxpayers make use of the provision than was deemed necessary to accomplish the objective, the cost to the government may be larger than anticipated. This risk of foregoing large amounts of revenue with little net gain in terms of creating additional activity is perhaps the greatest risk associated with tax expenditures.

- There are "grandfathering" provisions designed to protect taxpayers against changes in the rules after a commitment has been made but before the transaction has been completed. These result in further program costs.

- It is difficult to focus on the desired target without increasing the complexity of the Income Tax Act and imposing the same kind of case-by-case review normally associated with direct spending programs.

- Taxpayers develop avoidance mechanisms such as the use of limited partnerships to convert a company's unused tax losses into cash or the Little Egypt Bump, which combines unrelated provisions of the Income Tax Act to produce results that were not envisaged by the legislative drafters. While it is virtually impossible to eliminate such mechanisms, it is our opinion that the Department of Finance should act in a timely manner to eliminate them when they have been identified.

- The tax administration process is designed to encourage taxpayers to comply with the Income Tax Act rather than to ensure that program objectives are met.

- Modification of tax rates, increases in the level of personal exemptions, or Provincial government iniatives can change the effect of a tax expenditure program.

- Compliance problems caused by abuses or inefficiencies in a tax program can erode the revenue-generating capacity of the tax system by compromising its integrity. A badly designed tax program can also have an unintended effect on provincial revenues.

- Co-ordination of spending plans is hindered because funds spent through the tax system are insulated to a significant degree from explicit competition with other spending priorities for scarce budget dollars. Thus, delivering programs through the tax structure hinders the government's ability to assess accurately the value of such programs relative to other needs.

- Tax expenditures make control over government spending more difficult because funds spent through the tax system are harder to monitor than those disbursed through direct assistance schemes. As a result, the government may not be able to respond effectively to unanticipated and undesirable tax spending program developments.

2.5 **The Department of Finance does not adequately manage tax-delivered programs.** In our opinion, the high-risk nature of the tax system demands that tax programs be subjected to management procedures that recognize these risks. The Department of Finance does not subject tax programs to appropriate pre-implementation and post-implementation procedures.

2.6 We looked at the management process and reviewed two related tax programs – the Registered Home Ownership Savings Plan and the Multiple-Unit Residential Building program. With respect to these programs, we tried to answer several questions that we think must be answered in assessing any program. We concluded that, although the

Department was aware of the importance of the issues raised, it did not consider them formally in assessing tax measures before and after they were implemented.

2.7 **The Department of Finance does not evaluate its programs adequately.** The Department believes that, in the course of modifying existing policies and tax measures, its Tax Policy and Legislative Branch performs program evaluations. We looked at four reviews cited by the Department as evaluations, and none of them met the requirements of the Comptroller General's guidelines on program evaluation. The Department has no consistent policy or requirements for its own internal evaluation work but operates on an ad hoc basis for each evaluation.

2.8 Where tax expenditure programs are used in combination with direct and other programs to accomplish government objectives in a particular area or sector, there is a need for a government-wide evaluation framework in order to eliminate duplication and measure the net results.

2.9 **Parliament does not receive all relevant information on tax expenditures.** We reviewed the major accountability documents presented to Parliament. The Fiscal Plan, the Estimates and the Public Accounts do not disclose government activities undertaken through the tax system. Costs are buried, and decision makers may thus assume that programs are less expensive than they are. A review of government initiatives in any area can only be effective if all the different methods of government intervention are taken into account and if similar budgetary techniques are used to evaluate the cost of tax and direct expenditures.

2.10 Parliament currently receives information on tax expenditure programs from three main sources: budget papers, explanatory notes to Bills amending the Income Tax Act, and tax expenditure accounts. However, we concluded that the lack of information on tax expenditures in the major accountability documents makes it difficult for Parliament to consider proposed legislation and hold the government accountable for the use of public funds.

2.11 We reviewed two cases where we believe Parliament did not receive all the relevant information regarding amendments to the Income Tax Act. Parliament's ability to assess the impact of proposals is seriously hampered in situations like these. (See Chapter 4).

2.12 **Crown corporations can bypass the normal parliamentary budgetary process and obtain government funds through the tax system.** For example, Canadian National claimed a reduction in income taxes for losses from prior years that had been fully reimbursed by the Department of Transport under annual appropriation acts; Petro-Canada is in a position to reap tax benefits because of the way it structured its purchase of Petrofina; and certain corporations wholly owned and partially owned by the Crown received over $100 million through the Scientific Research Tax Credit program.

CHAPTER 5 - YEAR-END SPENDING

2.13 **Background.** Parliament grants annual appropriations of funds to government departments and agencies. Unless otherwise provided, appropriations lapse at the end of the fiscal year for which they were approved. The lapsing of funds policy is a basic principle underlying parliamentary control of public money. It appears that this policy exerts pressure on managers to spend in order to avoid lapsing funds. There is a public perception that the government goes on a spending binge at the end of the fiscal year and that millions of dollars are wasted.

2.14 For our study, we categorized expenditures into two broad categories – discretionary and non-discretionary. The discretionary expenditures are those over which departments have a significant degree of control; they have little or no control over non-discretionary spending, such as expenditures required by legislation or specific agreement.

2.15 Total expenditure for 1984-85 amounted to $107.6 billion. Year-end spending in 1984-85 amounted to $18.4 billion. The majority of this spending – $13.4 billion – was non-discretionary. The $5 billion of discretionary spending at year end was $1.8 billion higher than the average for the rest of the year.

2.16 **Audit scope.** We examined spending at the end of the 1984-85 fiscal year to determine whether there was extra cost to the taxpayer because of spending at the year end. We defined the term "extra cost to the taxpayer" as describing situations where there was little regard for spending taxpayers' dollars wisely when making spending decisions. Our study focussed on the examination of discretionary expenditures because the departments have a significant degree of control over these expenditures.

2.17 We observed goods being received and stored at 31 March 1985, audited a sample of 1,309 discretionary transactions at year end, and performed supplementary audit work as appropriate.

2.18 **Extra cost to the taxpayer less in magnitude than generally perceived.** The sample we examined indicated that, in general, year-end expenditures were made on items that were within documented specifications and for which there was a defined need. But we also found instances where expenditures were made in advance of need or before the due date. Based on the results of our sample, we did a projection and estimated that the extra cost to the taxpayer of this spending was approximately $3 million in storage costs and foregone interest.

2.19 The physical observation of goods at 31 March 1985 and supplementary audit work also resulted in several additional observations of payments in advance of need or before the due date.

2.20 There is extra cost to the taxpayer because of year-end spending, but it is of less magnitude than generally perceived. We believe that the lapsing of funds policy is a major reason for the pressure exerted on managers to spend in order to avoid lapsing funds with a resultant extra cost to the taxpayer.

2.21 **Methods used to avoid lapsing funds.** We also found three methods used by departments and agencies to avoid lapsing funds. We found cases where transactions were recorded in the wrong year, contracts were amended as the year end approached to change the delivery point of goods, and payments that would normally be made in a future year were moved forward to the current year.

CHAPTER 6 - CANADA EMPLOYMENT AND IMMIGRATION COMMISSION

2.22 **Background and audit scope.** The Canada Employment and Immigration Commission (CEIC) administers three programs: Employment and Insurance, Immigration, and Corporate and Special Services. The objective of the programs covered in part by our audit – Employment and Insurance – is to foster the achievement of social and economic goals by making human resources fully productive.

2.23 Within this program our audit covered direct job creation and professional training and within these two activities, we audited the Employment Creation Grants and Contributions (ECGC) program, the Local Employment Assistance and Development (LEAD) program, and the National Institutional Training program.

2.24 **Employment Creation Grants and Contributions program – to create jobs for the unemployed.** ECGC is a special direct job creation program. It was set up in the spring of 1982 to permit rapid implementation of projects put forward under the Special Employment Initiative announced in the Budget of 28 June 1982. Since its inception, some $200 million has been spent on the program to create jobs for the unemployed in community-based projects such as construction and improvement of sewers, city halls, bridges, industrial parks, sports centres and churches, as well as tourism development.

2.25 **Normal administrative procedures sidestepped.** Heavily influenced by elected representatives, the program sidestepped normal administrative procedures so that job creation projects could be launched more quickly than usual. However, under this influence, hardly any safeguards were provided to ensure that the projects and the program would achieve their primary objectives.

2.26 **Very limited role played by CEIC in ECGC program.** The role played by CEIC in achieving the objectives of the ECGC program was limited to that of an intermediary. The Commission served as a secretariat and its officials had no part in seeking out applications, identifying and selecting projects, or assessing the quality of those approved. For its other job creation programs, these are normal responsibilities for the Commission. In the case of ECGC, however, ministers and members of the House of Commons played the dominant role in these processes. This caused projects to be announced publicly before they were assessed by departmental officials and projects to be approved that showed little regard to economy or effectiveness in creating jobs for the unemployed.

2.27 Elected representatives are responsible for developing policies and are accountable to the electorate for their implementation and for related programs. However, in exercising this responsibility, they must be careful not to jeopardize the achievement of a program's objectives or its economical and efficient operation.

2.28 **Eligibility criteria permitted almost any proposal to be accepted.** The eligibility criteria for the program approved by Treasury Board were too broad. This meant that virtually any project proposed was accepted. An examination of the projects showed that stricter criteria and controls should have been imposed on projects to ensure that the objective of creating jobs for the unemployed was achieved.

2.29 **CEIC officers were not encouraged to monitor projects.** The procedures for assessing projects under ECGC appeared to be designed to allow the rapid disbursement of funds. The operational guidelines for the program gave little guidance to officials on how to interpret eligibility criteria or to evaluate projects, and did not encourage them to monitor projects. The results were that funding requests were approved without sufficient attention to their likely effects on the creation of jobs for the unemployed and to the cost of the jobs created. In almost half the projects, the cost was more than $1,000 for each work-week created, compared to $311 per week in the Canada Works Program. In spite of the Commission's limited role in approving projects, the financial procedures and controls it established were adequate to ensure that the amounts disbursed to project sponsors were in fact spent on approved project activities.

2.30 **Local Employment Assistance and Development Program - to ensure creation of permanent jobs.** The LEAD program was intended to increase the number of permanent jobs in areas of fewer than 50,000 inhabitants that suffered chronic unemployment. Over the two-and-a-half years of its existence, more than $188 million was spent under the program.

2.31 **Approval of funds based on unreasonable assessments of viability.** CEIC did not specify its expectations with respect to the continuation and self-sufficiency of the projects and the corporations to which it was providing long-term financial assistance, generally for five years, with the aim of creating permanent jobs. Each year, CEIC was required to assess the viability of the recipient enterprises before renewing funding for another year. Additional funds were approved each year, based on unrealistic and unreasonable forecasts and projections supplied by project sponsors. We noted many examples where, when enterprises were receiving funds, their viability was very uncertain.

2.32 **Not enough attention paid to creating permanent jobs.** The main objective of the LEAD program was to increase the number of permanent jobs. The operational definition of this objective was not clear for implementing the program effectively and accounting for results. For example, operational guidelines refer to creating avenues of employment that increase the number of "continuing jobs", and permanent jobs were defined as jobs where people work "full-time or part-time" for an indeterminate period or at regular intervals. The absence of clarity resulted in insufficient attention being paid to the requirement that permanent jobs be created when analysing project proposals and assessing results. CEIC had difficulty in compiling results achieved and was unable to provide Parliament with adequate information about the results.

2.33 **Institutional Training program cost $922 million in 1985-86.** These expenditures covered the cost of the Commission's purchases of training in vocational training schools, colleges, and technical institutes, as well as the cost of paying training allowances and related benefits to trainees. Over 200,000 Canadians a year have benefited from this program.

2.34 Over its long history, the federal role in training people has evolved from sharing the costs of constructing and operating provincial vocational institutions to purchasing training to meet the Commission's objectives. Under the 1982 National Training Act, the federal objectives were specified as providing "occupational training to better meet the needs for skills created by a changing economy" and "to increase the earning and employment potential of individual workers".

2.35 **The Commission has had difficulties in attaining its objectives.** Performance measures and a program evaluation study, within their limitations, indicated that the Commission has had problems in meeting its objectives. For example:

- In 1984-85, 27 per cent of skill trainees took training in occupations designated as of national importance; that is, occupations that are or are potentially in serious short supply.
- In the same period, 44 per cent of trainees in skill training were not working within 90 days after completing their training; of those working, only half were working in areas directly related to their training.
- There was no significant increase in earnings or employment for a group of 1983 trainees as compared with a group of non-trainees.

2.36 **Decisions greatly influenced by provincial or territorial objectives.** One reason for the Commission's difficulties in attaining its objectives is that the purchase of training is governed by bilateral agreements that provide for minimum annual guaranteed amounts to provinces and territories of as much as 90 per cent of total funds committed to the purchase of training, regardless of labour market needs. The agreements specify joint decision making on training purchases, based on consensus between the two levels of government. These decisions are therefore influenced significantly by the desire of the provinces and the territories to maintain a stable and continuing institutional training system.

2.37 Other factors that influence the economy and efficiency of training purchases include perceived "moral commitments" by some CEIC regions to support provincial training institutions funded under other CEIC programs, lack of current guidelines and benchmark information regarding costs for use by regions in negotiations, and non-compliance by provinces with certain financial and audit requirements under the agreements.

2.38 **About 40 per cent of training expenditures is for training allowances or unemployment insurance benefits.** In our audit of the payments, we found that 13 per cent of trainees whose payment histories were examined were overpaid, and 10 per cent were underpaid. The average error was $106 per trainee. This represents approximately one week's regular allowance for trainees that are on course 18.5 weeks on average. We also found that the validity of trainee information declarations was not adequately or consistently checked, increasing the likelihood of benefits being paid at inaccurate rates and increasing the potential for setting benefits at improper levels.

2.39 **Grants and contributions.** Prior to 1981-82, CEIC used mostly contributions to fund job creation projects. Since then, the Commission asked for and obtained permission to use grants, first for the ECGC program and later for LEAD.

2.40 **Different interpretation of grants by CEIC.** The definition of grant, set out in section 9.4 of the Financial Administration Guide, is open to interpretation. For several years, the distinction between grants and contributions has been blurred by the fact that the unconditional nature of grants has been interpreted very loosely. Given this, the Commission addopted different positions about the role of its officials in supervising, monitoring and evaluating projects funded through grants. In the ECGC program, CEIC took the position that no monitoring, audit or evaluation was required for projects funded by grants. However, monitoring was required for LEAD corporations.

2.41 **If monitoring and follow-up are necessary, contributions should be used.** The use of grants may have certain advantages for the granting agency, such as reducing the number of resources that have to be devoted to monitoring and follow-up. Because a grant does not require stringent monitoring or audit, a department should not use it unless it can demonstrate clearly that it is a more effective way of achieving a program's objectives. If the department believes that some monitoring and follow-up are essential, it should use contributions as the funding mechanism. Should grants be used, controls regarding eligibility, payments and evaluation should be specified.

2.42 **Parliament not adequately informed.** Parliament was not adequately informed about the nature of the ECGC program, about the use of funds and about the actual results achieved. For the LEAD program, the information it received about jobs created was not accurate or reliable.

CHAPTER 7 - CORRECTIONAL SERVICE OF CANADA

2.43 The Correctional Service of Canada (CSC) was established in 1977 through a merger of the former Canadian Penitentiary Service and the National Parole Service (then part of the National Parole Board). CSC's objective, as defined in the Estimates, is "to administer sentences imposed by the courts and to prepare offenders for their return as useful citizens to the community". The 1985-86 Estimates provided for $796 million and 11,105 person-years to achieve this objective.

2.44 **During 1985-86, CSC had an average of 12,400 inmates registered in addition to 6,000 persons on parole or under mandatory supervision.** Under the provisions of the Criminal Code of Canada, persons sentenced to two years or more are imprisoned in a federal penitentiary. Those who receive a prison sentence of less than two years go to a provincial reformatory or jail.

2.45 **Changes since our previous (1981) audit.** We noted that CSC had responded positively to our recommendations by strengthening its administrative controls. In November 1984, an Advisory Committee appointed by the Solicitor General to advise on the Management of Correctional Institutions reported that the improved corporate controls that had initially enabled steady progress were now becoming excessive and were adversely affecting the morale and flexibility of the field staff. In response to this report and a Treasury Board call for restraint on expenditure, the present Commissioner, who took office in February 1985, initiated 21 organizational and resource management reviews, covering almost all aspects of CSC's operations. As a result, significant changes are being made in CSC. The thrust is on increasing regional and institutional autonomy and reducing costs. It is too early for us to assess the complete impact of these changes. Where possible, we have commented on their potential impact.

2.46 **Imbalance between planned capacity of institutions and inmate population forecasts.** We compared the capacity of existing institutions, and those under construction as of 30 April 1986, with the latest forecast of inmate population for 1992-93. We found that there was an imbalance between the capacity and the forecast at various security levels. Although an excess capacity of 705 cells is foreseen at the Protective Custody and maximum security levels, there will be a shortage of 1,478 cells at the medium security level. The excess capacity at the Protective Custody and maximum security levels will be mainly in the eastern regions of Canada, with some shortage in the western regions. The shortage at the medium security level will exist in all regions.

2.47 The imbalance is attributable mainly to three factors. First, new institutions at Protective Custody and maximum security levels were initially planned either to replace older institutions or to provide for additional capacity in view of a forecast increase in inmate population. Later, CSC's thinking changed, and it decided to renovate and retain the older institutions as well, resulting in a surplus in the planned capacity. Second, CSC policy has been that, even though a Protective Custody institution is generally built to the same security specification as a maximum security institution, the Protective Custody and the maximum security inmates should not be put in the same institution. Consequently, even where there was a surplus capacity in a maximum security institution, it was not used to accommodate Protective Custody inmates, and separate institutions were built for them. Third, the decisions have been influenced not only by program needs but also by other considerations such as providing economic benefits to depressed areas. The cases in point are those of the construction of a Protective Custody institution at Renous, New Brunswick

(Atlantic Institution), a maximum security institution at Drummondville, Quebec (Drummond 1), and a Protective Custody institution at Port Cartier, Quebec.

2.48 The decisions to construct the three institutions had three significant effects. First, based on our most conservative estimate, CSC has committed itself to an extra capital cost of $27 million, and an extra operating cost of $30 million over the life cycle of Port Cartier. Second, while there is likely to be increased vacancies at the Protective Custody and maximum security levels in the eastern regions, there is likely to be increased double bunking of inmates at the Protective Custody and maximum security levels in the western regions and at the medium security level in all regions. Third, there could be an adverse effect on the achievement of CSC's program objective of preparing inmates for their return as useful/law-abiding citizens to the community.

2.49 **Level of double bunking is increasing.** Double bunking refers to housing two inmates in the same cell. CSC has been double bunking its inmates to overcome temporary shortages of accommodation at various security levels in its institutions. In February 1986, 780 inmates were double bunked, constituting approximately 7 per cent of the total inmate population. According to the 1986-87 Estimates, Part III, this percentage is expected to increase to 27 per cent in 1993-94. We found that in February 1986, even though the national percentage of double bunked inmates was 7 per cent, in 10 out of 61 institutions representing 34 per cent of the total inmate population, double bunking was over 10 per cent and up to 38 per cent of the inmates. The CSC officials we interviewed indicated that the negative effects of double bunking – increased risk of violence, for example – become more significant when double bunking increases. CSC is monitoring the situation and has identified a number of possible solutions to alleviate the problem.

2.50 **Lack of formally approved consistent performance standards and control over building design changes.** The lack of formally approved consistent performance standards and adequate controls over design changes during construction resulted in frequent and costly design changes after Treasury Board project approval. These changes amounted to $12.7 million for the three projects we audited, or about 14 per cent of total construction costs for the three projects, compared to an acceptable level of up to 5 per cent in the construction industry. The design changes included adding brick cladding over concrete walls at Atlantic Institution at a cost of $1.7 million to provide business to brick manufacturers in New Brunswick. In addition, as a result of a late decision to cancel the Special Handling Unit at Atlantic Institution, an extra $10 million was spent for which no value has been received.

2.51 **Lack of knowledge of whether offender needs are being met.** CSC does not know the extent to which it has been successful in achieving its case management objective of meeting offender needs – the Service does not know whether the aggregate needs of the inmates are being met with appropriate programs and services.

2.52 **Improvements required in efficiency and effectiveness measurement.** We found that even though CSC has undertaken a number of initiatives in recent years to improve its monitoring of the Industries program and its cost-efficiency, significant improvements are still required to enable it to measure adequately the efficiency and effectiveness of its Education, Training and Industries programs.

2.53 **Changes made to correctional officer (CX) recruitment, training and development without sufficient consideration for their impact on the overall CX recruitment, training and development program.** CXs are the main employment group in CSC numbering 4,100 and representing 40 per cent of the total CSC strength. During 1985-86, CSC made significant changes in its approach to CX recruitment, training and development with a view to reducing costs and decentralizing operations. Most of these changes were made without sufficient consideration of their impact on the overall CX recruitment, training and development program.

2.54 **Overtime expenditures could be reduced.** In 1984-85, CSC spent $29 million on overtime, of which $21.7 million was spent on overtime for the CX group. We found that CSC had not developed a means to assign the cost of overtime to its various causes and, as a result, it cannot define the significance of the various components of overtime, isolate problems, develop solutions, and set and measure goals. We believe that, at the operational level, CSC could reduce overtime by improved scheduling of staff and higher productivity through fewer employee absences. CSC is undertaking some initiatives in this regard. In 1985-86, CSC reduced its total overtime costs by $4 million compared to the previous year; $1 million on CX overtime, and $3 million on other overtime. Part of this reduction may be due to these initiatives.

2.55 **Inadequate management information systems.** In early 1985, a freeze was put on all systems development activities. The reasons for this decision were that users of the existing operational systems were dissatisfied because they had identified a large number of requirements that the new computerized systems were not meeting. There was no long-term plan for the large number of systems initiatives under way, and the base budget for systems development was insufficient.

2.56 CSC appears to be on the way to resolving its difficulties in this area. It is currently preparing a long-range systems plan outlining its systems development priorities.

2.57 **Internal audit.** We observed that the internal audit function had an appropriate mandate and reporting relationship and that its reports and follow-up were adequate. We found that since our previous audit, CSC had taken steps to improve the efficiency and quality of its internal audit. However, we were concerned that a proposed change in the role of the internal audit with respect to the audit of institutions would impair objective and independent reporting to management, on the affairs of the institutions. Furthermore, we felt that the internal audit function should strengthen its expertise in value-for-money and computer auditing areas, and improve its audit approach and documentation of its audit work.

2.58 **Lack of compliance with policy on program evaluation.** A corporate program evaluation function has existed in CSC since 1981. We found that a satisfactory mandate for program evaluation had been established but that departmental officials, including senior management, have not been complying with CSC policy on program evaluation and the related Treasury Board policy circular. As a result, the current program evaluation function in CSC does not represent satisfactory procedures for measuring and reporting program effectiveness on a periodic basis.

2.59 **Improvements required in reporting to Parliament.** CSC's two major reports to Parliament are Part III of the Estimates and the CSC chapter in the Solicitor General's Annual Report. Our review of these reports indicated that the Service's reporting, although generally satisfactory, is sometimes inadequate. Accordingly, these documents have not been entirely appropriate to enable their readers to make properly informed reviews of CSC's programs and their associated expenditures.

2.60 **Parole program.** The National Parole Board has not developed explicit criteria for making decisions on the granting of parole. As a result, the Board does not have an appropriate basis to assess the equity, quality and effectiveness of its decisions. Furthermore, there has never been an evaluation of the Parole program.

CHAPTER 8 - AGRICULTURE CANADA

2.61 The Department of Agriculture has existed since Confederation. The current mandate of the Department, founded on a legislative base of some 40 Acts of Parliament, is to promote the growth, stability and competitiveness of the agriculture and food (agri-food) sector. This involves not only farming but also food processing, marketing of food products and a variety of associated industries.

2.62 Significant issues that face farmers and the food industry, such as increasing competition in international markets, declining returns to farmers, and soil degradation have prompted the federal and provincial governments to work together on solutions.

2.63 There is a great deal at stake. The agri-food sector accounts for 15 per cent of the work force and 25 per cent of our trade surplus. Canadian consumers spend some $40 billion a year on food. Farmers' annual gross receipts total about $20 billion, including the value of exports. Combined annual federal and provincial government expenditures on agriculture exceed $3 billion, roughly equal to the net income of farmers.

2.64 In carrying out its wide-ranging programs, the Department must consider many different, and sometimes competing, interests in the agri-food sector. It must also administer certain programs jointly with provincial governments.

2.65 **Audit scope.** We looked separately at the management of all branches we audited this year, focusing on management's regard for economy and efficiency and on procedures to report the effectiveness of programs. We audited contribution payments designed to protect the incomes of farmers, research activities, and programs for managing community pastures and prairie water development. We also reviewed strategic planning, marketing and economic services, human resource management and health and safety practices. We followed up our 1982 audit recommendations in the areas we audited this year.

2.66 **Potentially avoidable expenditures.** We noted instances of an apparent lack of due regard for economy. Errors or a lack of due regard for economy in commodity support payments produced overpayments of $4.2 million over six years; concessional interest terms totalling approximately $200,000 were granted by the Agricultural Products Board; the Department paid $405,000 more than the appraised value in acquiring land for a new agricultural research site; and its renewal of a lease cost taxpayers $315,000 more than necessary. There are also opportunities for improvement. The Prairie Farm Rehabilitation Administration could reduce pasture management costs and improve operational efficiency.

2.67 **Lack of documentation to support program decisions.** We were concerned about the lack of evidence of information provided to the Minister to help him make significant decisions. This includes limited analysis of the financial effects of modifications to the payment formula contained in the Western Grain Stabilization Act, the lack of assurance on the actuarial soundness and self-sustainability of crop insurance plans, and the delay in highlighting the rising federal share of the costs of such programs.

2.68 The Western Grain Stabilization Act was amended in 1984 to provide the option of higher payouts to farmers. The decision to increase the level of payouts was not supported by an actuarial assessment of the financial sustainability of the fund or an analysis of the relationship between levies received from farmers and payments made. Moreover, discretion exercised by the Administration resulted in $185 million more being disbursed than may otherwise have been required for the 1984-85 crop year. This raises two issues: first, whether the program is being managed with a view to maintaining financial viability, considering the needs of both present and future grain farmers; and, second, the need for the Minister to be formally informed of any discretion exercised under the Act.

2.69 **Deficient health and safety practices.** We saw unidentified and improperly stored toxic waste at several Agriculture Canada facilities. Responsibility for developing safety procedures has not been effectively assigned, and identification and storage practices are poor.

2.70 **Slow response to 1982 audit observations.** Problems reported during our 1982 comprehensive audit largely remain in the areas we audited this year. A lack of urgency has been demonstrated in addressing earlier concerns in the management of research operations, human resource planning and health and safety practices.

2.71 **Non-compliance with spending authority granted by Parliament.** We noted that, over the past three years, $100 million has been used to finance costs incurred by the Canadian Dairy Commission in marketing dairy products. This use was not specified in parliamentary spending authority or in the Regulations accompanying the Agricultural

Stabilization Act. The Agricultural Stabilization Board intends to obtain clear authority in this regard.

2.72 **Improvement needed in program co-ordination and strategic planning.** On balance, the Department reacts to immediate pressures and concentrates on specific problems as they arise. Branches see themselves as independent units rather than as part of an overall long-term strategy. Program linkages are not well developed and cost-benefit analyses of alternatives are limited. During our review of program planning in the Prairie Farm Rehabilitation Administration, for example, we found that there were significant gaps in the strategic plan for rural water development needs, and only limited assessment of the effectiveness of funding practices. We also found that greater national direction was needed to improve the management of research activities.

2.73 **The purpose and effect of programs are sometimes confusing and not clearly communicated to Parliament.** The Agricultural Stabilization Act indicates that the purpose of dairy subsidies is to stabilize the price of industrial milk and cream to ensure a fair return to the industry. The stabilization of industrial milk prices appears to be achieved through support prices for butter and skim milk powder rather than subsidy payments and to be directed to helping dairy farmers maintain a prescribed level of income. It may also serve to lower consumer prices or ensure processor profits. However, because there is no definition of what a fair return or an efficient producer is, it is not certain that the purposes intended by Parliament are being served.

2.74 **Better information to Parliament is needed.** Improved accountability to Parliament could be achieved by reporting, for example, the level of commodity support in comparison to the significance of the commodity, the measures of fair return to producers and fair share of Gross National Product, and trends in the cash flow, income and equity of farmers.

2.75 **The Department is working to improve its management systems and practices.** An operational planning framework was developed by the Department in 1985, and performance measurement requirements have been identified and are being developed. The Department has a series of management improvement projects to be carried out over the next five years. And, in response to the Ministerial Task Force on Program Review, the Department has begun to modify its approaches to planning, priority setting and resource allocation. It is too early to know if these initiatives will improve program management.

CHAPTER 9 - EXTERNAL AFFAIRS, TRADE FUNCTION

2.76 In January 1982, the Department of External Affairs became responsible for the Trade function previously managed by the former Department of Industry, Trade and Commerce. The purpose of the restructuring was to ensure a greater measure of coherence in managing Canada's international relations by making economic and trade considerations a more integral part of foreign policy. The Department delivers the Trade function through direct funding programs such as the Program for Export Market Development, and through the services of Trade Officers located in the United States and abroad.

Level of Service at Posts

2.77 **The Department of External Affairs has not formally determined the level of service to be provided at Posts.** The Department has not established guidelines concerning the type and extent of services to be provided by Posts based on local conditions. Trade Officers, therefore, must decide on the level of service they will provide on the basis of their own assessments of the situation. Because resources are limited and the cost of providing these services is high, the Department of External Affairs needs to establish clearly the level of service to be provided by Posts in response to requests for assistance received from the business community.

Program for Export Market Development

2.78 The Program for Export Market Development (PEMD) is External Affairs' main program for promoting international trade. It is delivered jointly with the Department of Regional Industrial Expansion (DRIE). Although External Affairs' PEMD office has overall responsibility for the program, no organizational unit in DRIE is responsible for overseeing the delivery of the program by the 20 DRIE delivery units. Furthermore, the PEMD managers have not translated program objectives into measurable operational objectives.

2.79 **Eligibility criteria are difficult to apply and are not uniformly applied,** particularly where it is not clear if a company would have proceeded without government assistance. In such cases, a company is not eligible for funding. In addition, companies with poor records of success in using PEMD funds, and companies that had not submitted the required reports on prior projects, have received continued support.

2.80 **Inadequate controls over recovery of PEMD funds.** Although departmental controls over commitments and cheque issue relating to PEMD projects are generally satisfactory, this is not the case with respect to monitoring projects or recovering PEMD funds, which must be repaid if a marketing initiative results in new export sales by the company. Business Data Reports are required and are used as the basis for calculating repayments. However, these reports are often incomplete or not submitted. Since departmental audits of companies have indicated a high rate of non-reporting of sales, money owing the Crown may not have been collected. Procedures to identify and collect recoverable PEMD contributions do not ensure that maximum recoveries are made and do not comply with Treasury Board guidelines.

Operating Relationships

2.81 **Clear guidelines on operational arrangements with other departments needed.** The Department uses the sectoral and technical expertise of other departments to develop trade policy, identify Canadian sources of supply, and develop marketing strategies and plans. However, at the operating level no consensus has been reached between the Department of External Affairs and these other government departments on the best method of working together in pursuit of international trade development. No guidelines have been established on what the operating relationships with these other departments should be.

Information

2.82 **Inadequate information management procedures for Trade Officers.** Information is a fundamental component in the management of the international Trade function. External Affairs' Trade Officers abroad are involved in assessing international market conditions and developing market sector strategies for Canadian goods and services. This role is carried out by collecting, organizing and disseminating trade-related information. This information, however, is not regularly documented in an easily retrievable fashion and communicated back to Headquarters or to Canadian business. However, in response to specific requests, the Department can, and does, produce reports and briefing material on market conditions and sectoral strategies.

2.83 Trade Officers are regularly replaced with new incoming personnel, but there are no documented handover procedures to ensure continuity in the maintenance of business contacts or the collection of trade information. No centralized group is responsible for establishing or implementing policies for collecting, analysing and disseminating trade statistics.

Planning

2.84 **Lack of complete planning information.** The Department has a formal planning system to maintain the flow of information to Headquarters on Post activities. The design of this system is appropriate, but the information is not complete. The plans identify current resources and initiatives to be undertaken in the new year. However, they do not reflect the complete range of tasks performed by Trade Officers, and they do not accurately record how resources were actually used. Most of the trade resources are used to provide services for the business community, but data have not been collected on the demand for these services. This lack of complete and reliable data on the use of resources makes it difficult to assess the appropriateness of the current levels of staff or their deployment. The Department is introducing a new Trade monitoring system to correct some of these problems.

Computerized Information Systems

2.85 **Need for co-ordinated approach to EDP development.** The Department has about a dozen different computerized information systems. Estimated expenditures for electronic data processing equipment for 1985-86 were $11 million, a sizeable portion of which was to be devoted to Trade. We found significant problems of incompatibility among them. In a departmental communications system including 121 Posts spread around the globe, this has significant implications for increased costs of hardware, software, training and data transfer, and indicates the need for central control of future EDP systems development.

Managing Human Resources

2.86 **The human resource planning system does not sufficiently specify current and future human resource requirements for Trade positions.** Also, the selection process does not consider candidate market sector skills until after a short list of candidates has been established. Consequently, the most suitable candidates may not be considered for specific jobs.

2.87 Once a candidate is chosen, there is no documented handover procedure to ensure a smooth transition of duties. Training to familiarize candidates with the issues associated with the sectors to be represented is not routinely provided. Officers are expected to understand the relevant issues through on-the-job exposure. Given the complexity of the issues being pursued, officers have expressed uncertainty with respect to specialized sectors and the length of time needed to become fully effective. This presents problems of continuity, corporate memory and level of service.

Potential for Cost Recovery

2.88 **Charging for services.** It is expensive to maintain Trade Officers in the United States and abroad. Providing the wide range of services offered to the business community by the Posts is labour-intensive. With only one minor exception, there are no charges for these services. The work of the Posts is important to the expansion of Canadian trade, and the demand for their services is high and likely to increase. We believe that the value of and demand for services provided at Posts is capable of sustaining, and would justify, a measure of cost recovery.

CHAPTER 10 - FISHERIES AND OCEANS PACIFIC AND FRESHWATER FISHERIES

2.89 Fisheries and Oceans' Pacific Region is currently faced with two major problems – improving the overall management of the Pacific fishery, and managing its resources (people, money and equipment) more efficiently and economically.

2.90 **Plans needed to deal with fleet overcapacity.** In the Pacific Region, there are significant challenges in managing and protecting fish. The overcapacity of the fishing fleet, combined with over-investment and uncertain incomes for some fishermen, has caused the participants in the fishery to put pressure on the Department to allocate a larger portion of the available fish to them. It has also made fisheries management more difficult, complex and expensive. Under the current regulatory and management framework of the Pacific fishery, there are no plans, priorities or agreements in place that will enable the government and the industry to avoid the recurring economic problems that the fishery has experienced in the past, the attendant pressures for government expenditures, and the need for stock information to keep pace with the changing fishery.

2.91 **Need for better stock information to keep pace with changing fishery.** The Region has done a creditable job of managing the fishery, given the complexity and difficulty of the job. However, in doing so, it has relied to a large extent on the knowledge and dedication of its staff as opposed to developing management practices and information that will allow it to keep pace with the changing industry and to support fishery officers in managing the fishery. For example, although the primary purpose of the Region is to protect fish stocks from over-exploitation, the critical information required on stocks is inadequate.

2.92 **Improvement needed in resources management.** The Region also needs to improve its management of financial, materiel and human resources. This includes a need for better planning and allocation and better acquisition and use of equipment. The Region does not ensure that its resources are directed to priority tasks or that they are managed economically and efficiently. It needs to improve significantly its overall planning and budgeting system and its management of expenditure areas such as boats, engines, communications equipment, contracts and computers.

CHAPTER 11 - DEPARTMENT OF INDIAN AFFAIRS AND NORTHERN DEVELOPMENT

2.93 The Department of Indian Affairs and Northern Development, among its other responsibilities, must fulfil the legal obligation of the federal government, arising from treaties and the Indian Act, to administer Indian lands and trust moneys. Accordingly, the Department not only administers over $1.5 billion of public funds annually in providing basic services to status Indian and Inuit communities, but also manages over 2.6 million hectares (6.5 million acres) of Indian land and over $900 million of Indian moneys. Mismanagement of these resources can have significant consequences and, in fact, has led to payment of compensation through the courts.

2.94 Our audit focused on the Department's responsibilities in managing lands and moneys on behalf of Indians. We also examined the provision of elementary and secondary education to Indian children living on reserves or Crown lands, the implementation of Native Claims agreements, and the management of two development projects in the north.

Management of Indian Lands

2.95 **Need to clarify responsibility and mandate.** The Department does not know the full extent of its legal responsibility for the management of Indian lands. A 1984 Supreme Court of Canada decision held that the Crown has a fiduciary obligation to Indians with respect to surrenders of reserve lands that is enforceable in a court of law.

2.96 **Need to have an inventory of what the Department is managing.** For the Department to know what reserve lands it is responsible for managing and to make decisions regarding their use, it must have a complete inventory of such lands and natural resources held by individual bands. Its present systems do not fulfil this requirement.

2.97 **Lack of training and supervision of staff.** Employees dealing with land appraisals, legal surveys, contracts and leases often do not have the highly specialized knowledge necessary to discharge properly the Department's fiduciary responsibilities. They need this knowledge not only to do the work assigned to them but also to be able to identify problems when they arise. Very little training has been provided by the

Department. Furthermore, the Department does not provide adequate supervision to its staff and does not have adequate review mechanisms to ensure the quality of work being done.

Estate Administration

2.98 **Long delays and backlogs in estate administration.** Many of the staff responsible for administering Indian estates also do not have the knowledge and training to do their jobs properly. Because of this and because of a lack of staff, estates are often left unattended, delays in processing estates are excessive, and backlogs become unmanageable. For example, there are 300 new estates a year referred to the Manitoba regional office, which can only process 150 when fully staffed. It has been suggested that, if the preferential share of an estate that goes automatically to the surviving spouse were increased from the present $2,000 to the provincial limits – which range from $40,000 to $75,000 – there would be a significant decrease in the region's workload.

2.99 **Inadequate records kept.** We found that records kept on individual estates were inadequate. This means that, if claims were made against the Department or the estate administrator, it would be difficult to prove that proper steps were taken, and taken at the proper time.

Management of Indian Moneys

2.100 **Need to clarify its legal obligations.** The Department is not sure of the nature and extent of its responsibility following the transfer to Indian bands of the authority to manage their own revenue accounts. If the transfer is deemed to be a delegation, rather than a termination, of responsibility, the Department would have continuing obligation for these accounts.

2.101 **Release of trust funds without adequate safeguards.** At the time of our audit, there were 14,331 trust accounts for band members that are minors, with a total value of $99 million. Despite the requirement to hold a minor's share in trust until he or she reaches the age of majority, it has been the Department's practice to pay out a maximum of $3,000 a year for maintenance purposes to the minor's parents or guardian without obtaining the necessary written request and statement of need. On the basis of independent legal advice, it is our opinion that these funds were being released without adequate safeguards.

Elementary and Secondary Education

2.102 The annual cost, excluding capital outlays, is $409 million for providing elementary and secondary education to Indian children living on reserves and Crown lands.

2.103 **Lack of direction.** We found that some regions did not have program standards or operational guidelines for their district offices to follow. Also, the Department did not have adequate monitoring or information systems to provide feedback to various levels of management on the quality and level of educational services being delivered by federal and band-operated Indian schools, or on the educational achievement of Indian children.

2.104 **Improvement needed in education information.** There were no uniform data or statistics on the academic achievement of Indian children in relation to specific educational program initiatives. Consequently, the Department could not evaluate the overall effectiveness of the education program or the performance of federal and band-operated schools.

2.105 The lack of reliable information also prevented effective needs assessment and made it virtually impossible to measure progress in such areas as educational achievement of Indian children.

2.106 **Clear policies and procedures needed for transfer of control to Indian organizations.** The lack of clear policies, procedures or operational guidelines makes accountability for the delivery of education a contentious issue. The Department has not defined what it means by "Indian control" of education. It was not clear whether this meant that Indian organizations would merely operate and administer the schools under policies and regulations established by the Department or that they would be free to exercise their responsibility and decision-making capacity as would any elected school board in a provincial system.

Native Claims

2.107 **Lack of implementation plan and full cost information.** For the James Bay and Northern Quebec Agreement, we found that the timing, costs and responsibility for implementing the federal government's obligation were not adequately specified. In addition, the Department is required by legislation to submit an annual report to the House of Commons on the implementation of this agreement. It has not complied with this requirement.

Northern Affairs Program

2.108 We examined the major management systems, practices and controls associated with two economic development projects – the Nanisivik Mine in the Northwest Territories and the Cyprus Anvil Mine in the Yukon – and found them to be satisfactory.

CHAPTER 12 - DEPARTMENT OF INSURANCE

2.109 **The Department of Insurance is responsible for protecting the public against financial losses from the operations of federally registered or licensed financial institutions and pension plans.** It regulates some 560 insurance companies, trust and loan companies, investment companies and co-operative credit societies with total assets of over $200 billion, and over 750 employer-sponsored pension plans with assets of $28 billion. The Department also provides actuarial services to the federal government, principally in the area of pension programs.

2.110 **Audit scope.** Our audit focused on the Department's principal activities – the supervision of financial institutions and pension plans and the provision of actuarial services – and on the management processes that support them.

2.111 **Recent failures of regulated companies have resulted in the Department taking steps to improve its procedures for supervising financial institutions.** These include stricter incorporation procedures, more extensive monitoring of companies showing signs of potential financial weaknesses and field examinations strengthened by the addition of reinsurance and real estate expertise.

2.112 **However, we are concerned that while the Department has recognized those problems that led to the insolvencies, little time is being devoted to anticipating future industry trends and assessing potential new areas of risk.** As much as 50 to 100 per cent of senior management time for periods of up to several months has been directed to dealing with company failures and the fallout from them. Coping with this and other outside pressures has left managers with little time to assess future risks, let alone deal with regular, ongoing supervisory activities. As a result, the Department may not be able to deal adequately with new and changing situations in the financial community.

2.113 **The Department can also do much more to improve the efficiency of its supervisory procedures for financial institutions.** Limited use was being made of computer technology in many areas. Field examination standards and procedures required significant improvement; there were limited processes for resource allocation and budgeting, little evidence of planning and supervisory review, and poor documentation of work done. More reliance by the Department on the work of external auditors of the companies it regulates, and better co-ordination of the work of its regional and headquarters staff, would help prevent duplication of work, result in possible economies in person-years and allow the examination staff to focus more attention on important risk areas.

2.114 The small size of the Department, the frequent communication between senior management and all levels of staff, and the collective knowledge and experience of the employees have alleviated these problems to some extent. In addition, there are efforts underway in various parts of the Department to introduce better systems, guidelines and procedures. But, given the complexity and nature of the industries it regulates and the rapidly changing environment, the Department needs to question the usefulness of the techniques and procedures it was using 20 years ago.

2.115 **The Department regulates pension plans in a much less rigorous way than it regulates financial institutions. As a result, it is running the risk that present supervisory procedures may not permit it to monitor the financial solvency of pension plans adequately.** There are satisfactory procedures in place for monitoring compliance with legislative requirements, registering plans and reviewing actuarial reports. But in carrying out its supervisory role, the Department relies almost entirely on the representations of management. For instance, it does very little in the way of field examinations to obtain independent assurance that, for example, employee contributions have been paid into company pension funds, and that the companies apply appropriate management practices in administering their pension plans. Nor does the Department obtain independent assurance that the plans' investments were properly managed or conduct independent reviews to assess the underlying value of investments in real estate, mortgages and other such assets.

2.116 **Our review of the actuarial services provided by the Chief Actuary and his staff indicated work of a quality that met high professional standards. However, there is a problem with the timeliness of the information on pension plans for government employees.** Recently enacted legislation now requires tabling in Parliament of actuarial reports on federal pension programs within 18 months after the review date. Previously, there had been delays in tabling of up to five years. Current information on long-term costs and commitments of pension programs is an essential element in evaluating the adequacy of provisions for meeting future pension requirements.

2.117 **The Department needs to communicate more effectively with Parliament on the results of its work.** The information in the Estimates generally meets the standards of disclosure developed by the Office of the Comptroller General. However, the information in the Department's legislative reports to Parliament needs significant improvement. The annual reports on the supervision of financial institutions, despite recent efforts to reduce their size, are so voluminous (one report runs to over 400 pages) that Members of Parliament would not have time to read them. In contrast, the annual report on the supervision of pension plans provides only minimal information. Finally, the Department's actuarial reports on the Canada Pension Plan and federal public service pensions, the results of which should significantly affect decision-making processes, are written in such a way that, in general, only readers with actuarial knowledge can understand their financial implications.

2.118 The Department recovers most of its annual expenditures (which amounted to $19 million in 1985-86) from the entities it regulates and from government organizations. **Present billing practices have resulted in losses to the federal government of over $1 million in foregone interest in each of the last two fiscal years.**

CHAPTER 13 - VETERANS AFFAIRS PORTFOLIO

2.119 The Veterans Affairs Portfolio consists of the Department of Veterans Affairs and four related agencies – the Canadian Pension Commission, the Pension Review Board, the War Veterans Allowance Board and the Bureau of Pension Advocates. Together, according to the 1986-87 Estimates, they will have an expenditure of $1.6 billion, the eleventh largest among departments.

2.120 We last examined the Portfolio in 1980. This year, we focused on its three major expenditure areas: the War Veterans Allowance program, the Disability Pension program, and the Health Services program. We reviewed the status of many of the areas examined in 1980, with particular emphasis on the recommendations of the Public Accounts Committee.

2.121 Since there have been no new veterans since the end of the Korean conflict, many people assume that the Veterans Affairs Portfolio has a stable environment. In fact, its environment is as dynamic as that of any other government department because of the rapidly changing needs of its aging clientele. A number of internal changes – the relocation from Ottawa to Charlottetown, reorganization of the Portfolio, and a new senior management team – have also affected the Portfolio.

2.122 The move to Charlottetown was disruptive and caused problems for the Portfolio. The extent of effort needed to move and maintain acceptable levels of service delayed action on other problems.

2.123 Although we found a number of problem areas, management was aware of, and taking action on many of them.

2.124 **Legal duties of trustee not fulfilled.** We followed up on the audit note included in our 1985 Report and found serious weaknesses in the administration of $56 million held in trust accounts for veterans. These accounts are established to allow the Portfolio to administer the affairs of veterans unable to do so. The Portfolio has failed to fulfil the minimum legal duties of a trustee – the duty to pay interest on moneys held, the duty to supervise third parties administering accounts on behalf of the Portfolio, the duty to keep full accounts and to disclose them regularly, and the duty to ensure procedural fairness in establishing trust accounts. The Portfolio recognized these problems following a related court decision involving the Department of Indian Affairs and Northern Development trust administration. A Portfolio task force is examining possible solutions.

2.125 **Significant improvements in disability pension processing time.** In its report following our 1980 audit, the Public Accounts Committee expressed concern about the time taken to process disability pension applications. After examining the findings of the Marin Committee which investigated the situation, the Minister made a concerted effort, lasting over a year, to reduce this time to an acceptable level. This has been achieved and sustained.

2.126 **Many incorrect War Veterans Allowance payments are made.** For 1985-86, we estimate that there have been $9.4 million in overpayments to clients that were not preventable under the operating policies and procedures in effect during the time of our audit. An additional $26.4 million in overpayments could have been prevented. They could be prevented cost-effectively, for example, by developing with the Department of National Health and Welfare legislative changes and better procedures for co-ordinating War Veterans Allowance and Old Age Security/Guaranteed Income Supplement payments to veterans. The remainder could not have been prevented; for example, where new income information from a client is received after the monthly cheque is sent. During the same period, there were $3.8 million in underpayments to clients. Changes to the Act, effective 1 April 1986, should reduce the number of future incorrect payments.

2.127 **Incomplete long-range planning.** The Public Accounts Committee in 1980 shared our concern about the absence of long-range planning at that time. Considerable action has been taken in the past year to establish a long-range planning process, but much remains to be done before it becomes firmly established. Better information is needed to guide planning decisions. Among key programs, only the Veterans Land Administration has a completed long-range plan. Work is under way on a much-needed hospital bed plan, to ensure the availability of the beds that will be required as the veteran population ages. The War Veterans Allowance program needs a long-range plan for the next 15 years, as annual benefits decline from $450 million to $40 million. Decisions are needed soon on the future administration of the program before short-term decisions can be made, for example on the extent of computer investments needed.

2.128 **The Veterans Independence Program is an innovative response to client aging.** The program's intent is to delay the need for institutional care for veterans by providing health and maintenance services in their homes. This not only reduces hospital expenses but also maintains a more normal life for the veteran. Because the program is new, the Department has faced operational difficulties that will increase as the program is expanded. These operational difficulties include a cumbersome reimbursement mechanism. The Department is working to find a better system.

2.129 **Past computer system expenditures have not given sufficient value for money.** We found that the two key Portfolio computer systems – those used in the War Veterans Allowance program and the Disability Pension program – did not provide promised efficiency improvements. We estimate that $17 million was spent between 1978 and 1984 developing the War Veterans Allowance system, and $4.5 million developing the Disability Pension system. The systems had deficiencies that led to abandoning key systems features. Also, opportunities to improve efficiency were missed. In our opinion, they did not provide sufficient value for the money spent in developing and operating them. The Department is completing a strategic computer plan and has established a senior management steering committee to ensure better co-ordination of future development.

2.130 **In other areas, the Department has acted to improve efficiency.** The Department estimates that 130 person-years were reallocated to the growing Veterans Independence Program during 1985-86, because of new, more efficient War Veterans Allowance procedures.

2.131 **Major improvements are needed in financial management and controls.** We concluded from our examination of the Portfolio that there are significant financial management and control weaknesses. Some basic internal controls are absent, particularly reconciliations between systems to ensure the accuracy of accounting entries. Financial management information, although voluminous, is often incomplete and sometimes inaccurate. Much of it is of little assistance to management in identifying areas requiring action. Management was dissatisfied with financial information systems and was acting to improve them. In the area of budgeting, we could find little evidence of appropriate challenge and review in the development of past budgets.

CHAPTER 14 - SPECIAL AUDITS

Introduction

2.132 Much of the Audit Office's work concentrates on comprehensive audits of departments or government-wide audits. Over the past several years, however, the Office has begun to conduct "special" audits of specific programs or activities that would not be addressed by comprehensive or government-wide examinations.

2.133 During the last year, the responsibility for these special audits was consolidated and provision was made for the results of the work to be reported in one chapter.

2.134 The Special Audits group has been given the mandate to examine specific programs or activities within a department or across several departments. Normally, the audits will address matters that would not be audited on a regular basis, but that are important nevertheless. This approach will increase the efficiency and effectiveness of the Audit Office and at the same time allow the results of work to be reported to Parliament as quickly as possible. This year's chapter contains reports on:

- 11 capital projects involving proposed expenditure of $1.3 billion;
- the management of government publications distributed free of charge to the public;
- the management of the public communications function in the Department of Energy, Mines and Resources;
- the Social Sciences and Humanities Research Council; and
- the Canada Oil and Gas Lands Administration.

Capital Projects

2.135 We examined 11 capital projects with proposed expenditures of $1.3 billion as part of our ongoing examination of expenditures on capital projects. We found that, although the projects were generally well managed during the procurement stage, the planning leading to Treasury Board approval was lengthy and resulted in cost escalations, changes to the original concepts for procurement of equipment or for construction, and lack of clear justification for the level or type of facility built or equipment procured.

Free Publications

2.136 The federal government spent about $350 million on information (departmental publications and advertising) for the fiscal year 1984-85. We audited the expenditures made on publications distributed free to the public. We found that decisions to publish free publications were made generally without sufficient regard for economy and efficiency. No one can determine the total number of free publications or their costs.

Department of Energy, Mines and Resources - Management of the Public Communications Function

2.137 Our audit of the management of public communications in the Department of Energy, Mines and Resources (EMR) concentrated on how the Department communicates with the general public through the use of publications, advertising, exhibits and audio-visual services.

2.138 **Unclear responsibility for managing and co-ordinating the communications function.** The responsibility for managing the departmental communications function, particularly the publications function, is not clearly delineated between the central Communications Branch and the program areas. Also, because publishing is not co-ordinated department-wide, EMR cannot readily identify all its general-interest publications or produce the departmental publishing plan required by Treasury Board publishing policy. The public could have difficulty in locating the information they want from EMR.

2.139 **Weaknesses in product planning, cost information and evaluations.** Our detailed examination of 25 information products showed that the originators had given insufficient attention at the planning stage to defining the target audience, estimating costs, considering alternative means of communication, and planning for distribution. We also found weaknesses in recording and monitoring significant product costs. In addition, very few formal evaluations had been done to verify product effectiveness. However, Communications Branch has its own planning process for the general-interest products it is developing, and we did find considerable improvement in this process since a 1983 Internal Audit report.

The Social Sciences and Humanities Research Council (SSHRC)

2.140 SSHRC is a departmental corporation listed in Schedule B of the Financial Administration Act. It reports to Parliament through the Secretary of State. SSHRC's objective is to promote and assist research and scholarship in the social sciences and humanities and to encourage excellence in those fields. Its total expenditures in 1985-86 amounted to $63.6 million, of which 90 per cent was for grants and scholarships.

2.141 **Audit scope.** Our audit covered the management process, including roles and responsibilities, general planning and human resource management, operational control, research communication and program evaluation.

2.142 **Good controls over delivery of grants and fellowships.** The grant and fellowship payments that we examined had all been processed in accordance with the peer evaluation process SSHRC has in place, and had been approved by the President and/or Council. Our annual financial audit showed that financial controls were satisfactory.

2.143 **The roles of the different management levels should be clarified.** Matters relating to day-to-day operations were frequently dealt with at all levels of management, including the Senior Management Committee, the Executive Committee and Council. This situation leads to overlapping, delays in action and inefficient operations. There were also delays in reaching solutions to some problems referred to Council, such as the development of a system to monitor the results of the research it supports and the organization of a task force to study the operational objectives of the Strategic Grants Division.

2.144 **Lack of overall operational planning.** Senior management has not established an overall operational plan covering its priorities, target dates and the co-ordination of its activities. Thus management could not adequately plan its human resource needs. In addition, work load indicators had not been established and the tasks to be performed and the number and category of employees needed had not been defined. Adequate plans were not prepared to minimize the impact on employees following layoffs and necessary person-year reduction. As a result, there was no assurance that operations were economical, efficient and effective.

2.145 **Insufficient attention given to the results of subsidized research.** Assurance was not always obtained that subsidized projects had been completed and complied with the terms of the grant agreement. SSHRC was not in a position to know what had been produced for the amounts invested in research. As well, the position of co-ordinator of the program evaluation function has remained unfilled for 19 months. During this period, no new initiatives have been taken in program evaluation. As a result, there has been a reduction in information on which to base program decisions.

The Canada Oil and Gas Lands Administration (COGLA)

2.146 COGLA represents the interests of both the Minister of Energy, Mines and Resources and the Minister of Indian Affairs and Northern Development with respect to their responsibilities under the Canada Oil and Gas Act and the Oil and Gas Production and Conservation Act. Its mandate is to ensure the vigorous and responsible development of oil and gas on lands under federal jurisdiction that are not within a province.

2.147 **Audit scope.** The objective of our audit was to identify matters that, in our judgement, were of significance to Parliament, particularly with respect to due regard for economy and efficiency and the procedures to measure and report on effectiveness.

2.148 **Rights management process.** The rights to explore for and develop potential oil and gas resources are conveyed to explorers by way of exploration agreements negotiated by COGLA on behalf of the appropriate Minister. A transaction fee is charged to the explorer for each exploration agreement entered into or re-registered.

2.149 Delays in presenting final documents to explorers for execution and COGLA's failure to calculate and assess these transaction fees promptly has reduced the likelihood of collecting fully approximately $1 million in revenue.

2.150 **Program evaluation.** At the time of our audit, COGLA had not yet undergone a program evaluation study.

2.151 **Audit terminated early.** Our original timetable suggested completing and reporting on our examination of COGLA in 1987. However, after our initial survey, we determined that, with the exception of those items outlined above, there were no other matters of significance and of a nature that should be reported to Parliament. In our opinion, it is unlikely that further audit work would identify additional matters of significance. Accordingly, we terminated our audit before the detailed examination phase.

AUDIT NOTES

AUDIT NOTES

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3

AUDIT NOTES

Introduction

3.1 This chapter contains matters of significance that we believe should be drawn to the attention of the House of Commons. They have not been reported elsewhere in the Report, but have come to our attention during our audits of the Accounts of Canada, Crown corporations and other entities.

3.2 Section 7(2) of the Auditor General Act requires the Auditor General to call Parliament's attention to any cases of significance in which he has observed that:

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency; or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

3.3 Each of the matters of significance reported in this chapter was examined in accordance with generally accepted auditing standards, and accordingly our examinations included such tests and other procedures as we considered necessary in the circumstances. The matters reported should not be used as a basis for drawing conclusions about matters not examined. The instances that we have observed are described in this chapter under the appropriate department, Crown corporation or other entity heading.

Observations on Crown Corporations

3.4 The Auditor General is appointed auditor of 44 Crown corporations, under the Financial Administration Act or individual Acts incorporating specific corporations. Details of significant reservations and other matters contained in reports issued to these corporations during the year are set out below. Most of these matters have already been raised in the public forum, but they are reported here for emphasis and for consideration by Parliament.

3.5 Canada Lands Company (Vieux-Port de Québec) inc. - Lack of due regard to economy, and not providing information to the Treasury Board, in the acquisition of assets

> The Canada Lands Company (Vieux-Port de Québec) inc. acquired certain assets at a cost of $1,977,469. In a submission to the Treasury Board, it did not mention the existence of an earlier agreement that provided for the transfer of assets to the Corporation at no cost. In addition, it discharged debts amounting to $429,876 of a third party without being bound to do so and without the approval of the Treasury Board.

3.6 For the staging of a festive event to commemorate the arrival of Jacques Cartier in Canada, the Corporation and a non-profit corporation, Quebec 1534-1984, signed an agreement of general understanding that set out the rights and obligations of each party for staging the event and for the use of the site and equipment under the jurisdiction of the Corporation. As compensation for the right to use the site, it was agreed that certain assets (infrastructures, temporary installations and equipment) put into place by Québec 1534-1984 would become the property of the Corporation at the termination of the agreement.

3.7 When the poor financial position of Québec 1534-1984 became known publicly, a submission was made to Treasury Board requesting a maximum of $2.5 million for the purchase of these same assets, and $1 million to contribute to program costs. Treasury Board approved the submission on 1 August 1984. By 22 August, the Corporation had contracted to pay a total of $1,977,469 for the assets – the amount, determined principally on the basis of purchase orders rather than invoices, that Québec 1534-1984 paid for the assets. On 23 August 1984, the Corporation paid $1 million to support the program costs. During 1984, the Corporation also discharged debts of Québec 1534-1984, amounting to $429,876, without being bound to do so and, without the approval of Treasury Board.

3.8 In our report on the examination of the financial statements of the Corporation for the year ended 31 March 1985, we brought to the attention of the Minister of Public Works that, in our opinion, pertinent information was not provided to the Treasury Board because the existence of an agreement that provided for the transfer of assets to the Corporation at no cost was not disclosed.

3.9 In addition, we brought to the attention of the Minister of Public Works that the Corporation has discharged debts amounting to $429,876 of a third party – Québec 1534-1984 – without being bound to do so and without the approval of Treasury Board.

3.10 In respect to the foregoing, we expressed the opinion that the Corporation did not manage its financial resources with due regard to economy.

3.11 Canadian Broadcasting Corporation - Inability to maintain proper books of account and internal control resulted in denial of audit opinion on financial statements

> Difficulties experienced during the implementation of a national financial system have resulted in the Corporation being unable to maintain proper books of account and internal control. Accordingly, in our audit report to the Canadian Broadcasting Corporation (CBC) and the Minister of Communications, we stated that we were unable to express an opinion on the financial statements of the Corporation for the year ended 31 March 1986, and that the Corporation did not maintain proper books of account from which the financial statements have been prepared.

3.12 Consistent with its objective of improving the management information function, the Corporation started the development of the National Finance System (NFS). The NFS is a very complex system designed to operate centrally while providing a service to many locations. The system includes up to nine modules, each one addressing a major financial management aspect of the operations. An objective of the system is to integrate the financial management and reporting functions across the CBC. The Corporation envisaged implementation of the system in three phases over several years, introducing the first one throughout 1985-86. Phase one includes three modules, namely (1) the general ledger, (2) budgetary control, and (3) accounts payable and purchase order control.

3.13 A number of very serious difficulties were experienced in implementing phase one and in maintaining proper books of account during the transition period. As a result, an unexpectedly large volume of accounting entries was recorded in special accounts that required detailed analysis and correction before proper accounting could be achieved. As a consequence, the Corporation has not been able to maintain the degree of internal control it had planned for, nor has the NFS produced regular, timely and reliable financial information and reports.

3.14 Because of the nature and extent of these problems and the abnormally large volume of accounting entries that had to be processed through the newly introduced system, we were unable to complete the audit and, accordingly, our audit report to the Canadian Broadcasting Corporation and the Minister of Communications states that we were unable to express an opinion on the financial statements of the Corporation for the year ended 31 March 1986, and that the Corporation did not maintain proper books of account from which the financial statements have been prepared.

3.15 We have recommended to the Corporation that, because public funds are at risk and several months have already elapsed into the next fiscal year, these problems must be corrected immediately. The Corporation has responded by announcing, on 28 August 1986, that a senior level committee has been established to develop an action plan to examine and address those critical matters that prevent proper internal control, accounting records and financial reporting from being achieved.

Observations on Departmental Operations

3.16 Department of the Environment - Late payment charges on telecommunications bills

> Delays in the processing and payment of billings from telecommunications and other companies have resulted in approximately $45,000 of late payment and interest charges to the Atmospheric Environment Service in Downsview, Ontario, for the 1985-86 fiscal year.

3.17 Approximately $27,000 of the $45,000 relates to one telecommunications company. When the Department receives billings, there are delays caused by performing a complete verification of all charges before processing the payment. There also appears to be delays caused by the need to apportion charges to the various responsibility centres.

3.18 Because the charges are governed by tariffs set by the Canadian Radio-television and Telecommunications Commission, there is a low risk of errors. Also, since they are billed monthly, any detailed verification considered necessary could be done after the payment is made, and any overcharges recovered from subsequent payments.

3.19 In addition to improving the efficiency of the payment processing procedures, due regard for economy could be improved by ensuring that payments such as these are made within 30 days, as directed by the Treasury Board Guide on Financial Administration.

3.20 Department officials are considering performing some of the detailed verification after the payment is made. They are also investigating ways to simplify payment processing procedures to reduce the time involved.

3.21 Department of Public Works - Non-compliance with Treasury Board contracting policy

> The Department of Public Works did not comply with Treasury Board contracting policy and Government Contracts Regulations in a number of instances. We noted incidents of project cost overruns, retroactive Treasury Board approval of contracts, contract splitting and entering into "starter" contracts. Treasury Board has expressed concern repeatedly about these occurrences, and the Department has indicated that corrective measures are being taken.

Cost Overruns and Retroactive Approval

3.22 The Treasury Board Administrative Policy Manual states that incidents of cost overruns and retroactivity will be considered by Ministers to be very serious evidence of expenditure being incurred without proper authority. In addition, it stipulates that contracts requiring Treasury Board approval shall be approved by the Treasury Board before they are entered into and before any work is begun.

3.23 Despite this, the following incidents of cost overruns and seeking retroactive Treasury Board approval occurred:

3.24 **Case 1.** In June 1985, the Department sought retroactive Treasury Board approval to increase by $1,298,000 the amount payable for the construction of the Special Handling Unit, Saskatchewan Penitentiary. Of the $1,298,000 for which DPW sought approval, some $1,211,000 had already been paid to the contractor without requisite Treasury Board authority. In approving the proposal, the Board expressed disapproval of cost overruns and of the practice of seeking retroactive approvals.

3.25 **Case 2.** In August 1985, the Treasury Board approved the Department's proposal to increase by $225,000 the amount of a services contract relating to phase one of the Regional Reception Centre project of the Sainte-Anne-des-Plaines Maximum Security Institution. The Board expressed concern over the retroactivity and cost overruns reflected in the proposal and requested that the Department inform Treasury Board Secretariat of the measures being taken to eliminate retroactive submissions and prevent cost overruns.

3.26 On 7 October 1985, the Department advised the Secretariat that corrective measures had been taken.

3.27 **Case 3.** In May 1986, Treasury Board approved in part the Department's request to increase by $712,000 the amount payable under a contract with an architectural firm for services relating to a new maximum security penitentiary institution in Donnacona, Quebec. Treasury Board noted that a major portion of the work for which authority was sought had been completed prior to the request being made to the Board, and that there had been significant cost overruns and underestimates of work to be done.

Contract Splitting and Entering into "Starter" Contracts

3.28 The Administrative Policy Manual cautions contracting authorities against splitting contracts or amending them to avoid the obligation of obtaining approval, as required by statute or the Government Contracts Regulations, for entry into contract. The Manual stipulates that departments shall not enter into contracts under their own authority where the contract constitutes the first step of a project that may require subsequent Treasury Board consideration.

3.29 Under the Government Contracts Regulations, the Department of Public Works may, without the approval of the Treasury Board, enter into a contract for architectural, engineering and other services if the amount payable under the contract does not exceed (i) $100,000 or (ii) $400,000 where the work has been specifically approved in writing by the Treasury Board.

3.30 In January 1984, the Department issued an internal memorandum specifying that it could not enter into a contract under departmental authority and later seek Treasury Board authority to amend the contract for subsequent stages. Nevertheless, we noted the following cases of contract splitting and entering into "starter" contracts by DPW.

3.31 **Case 4.** In July 1984, under departmental authority, the Department entered into an agreement in the amount of $93,750 for mechanical consulting services related to the relocation of three clients.

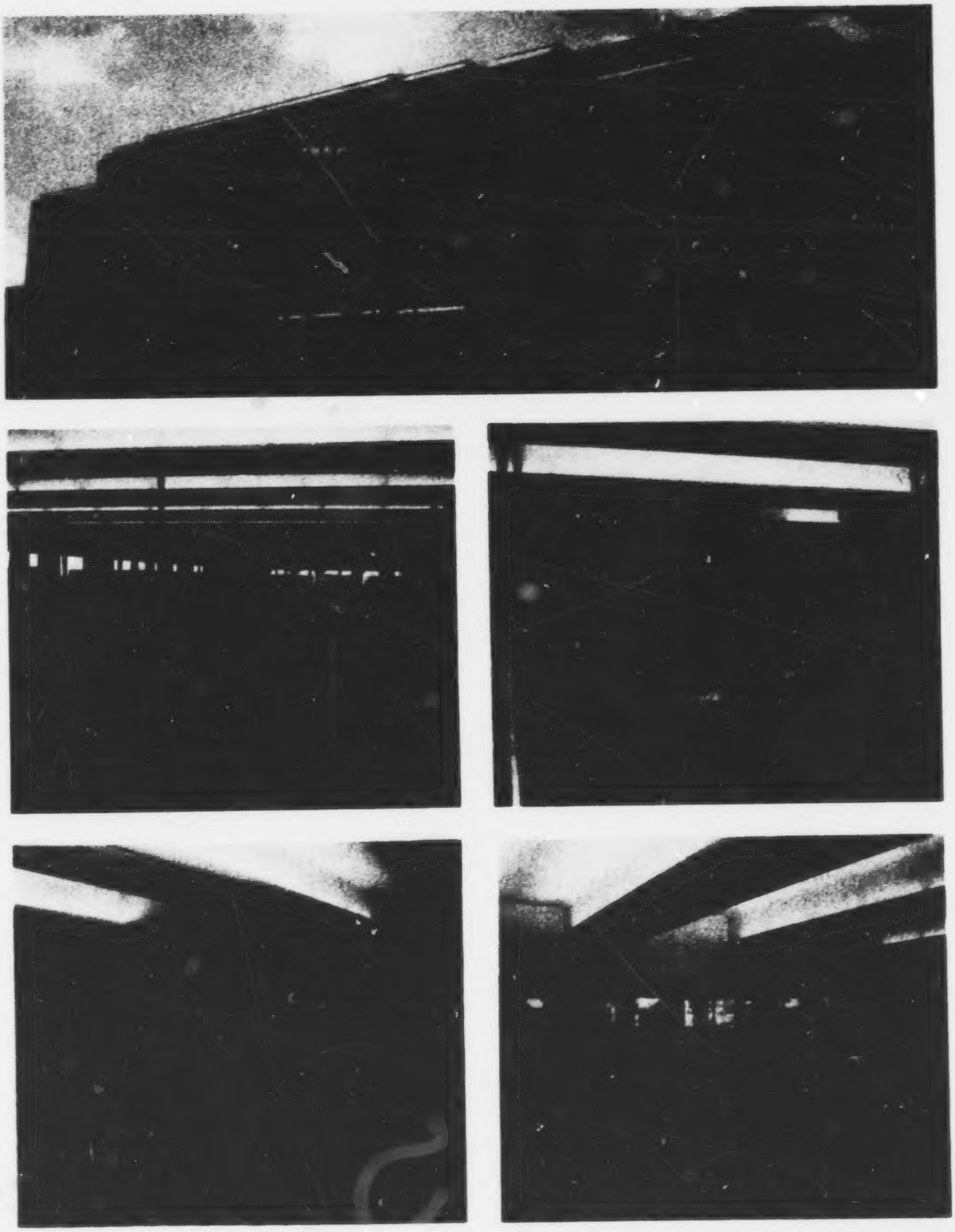
3.32 In January 1985, a departmental amendment for $56,000 was issued to cover the mechanical consultant services for special purpose areas, bringing the total contract amount to $149,750. A second departmental amendment for $30,750 was issued in September 1985 for additional mechanical fees required for re-designing the floors to an enclosed office concept requested by the client.

3.33 In December 1985, the Department sought Treasury Board authority to amend the contract and increase the amount payable by $80,000 for additional design work. Noting that the work had already been done, Treasury Board did not approve the contract amendment but authorized the payment for the work in the amount of $80,000.

3.34 **Case 5.** In September 1983, Treasury Board authorized expenditures to cover consultant fees for designing and preparing cost estimates for a research laboratory in London, Ontario. Proposals for consultant services had been received from four architectural firms, and the successful firm was approved by the Minister of Public Works in August 1983. The project was delayed until late 1984, and the consultant was reconfirmed in February 1985.

3.35 In April 1985, a contract for $250,000 was entered into under departmental authority for a project cost estimate and for preliminary design work. In December 1985, the Department sought Treasury Board authority to increase the total amount payable under this same contract by $789,657, for a new total to $1,039,657. In approving the increase in the total amount payable, the Board reminded Public Works of the Treasury Board policy regarding entering into contracts that constitute the first step of a project that may require subsequent Treasury Board consideration.

3.36 **Case 6.** Also in December 1985, the Treasury Board considered a Public Works request to amend a contract to provide for an additional amount of $226,660 to cover design, contract documents and supervision services for a sewage system on Moose Factory Island, Ontario. Treasury Board noted that the Department had again entered into a "starter" contract contrary to Treasury Board policy. An initial agreement was executed in November 1984 in the amount of $284,390 under departmental authority; this amount was increased to $360,140 in June 1985. The December 1985 request brought the total amount of the contract to $586,800.



This building in Hull, Quebec, was only 20% occupied at 30 June 1986, despite the fact that full rental payments have been made since 1 September 1985. The photographs show fitting up still in progress and unoccupied floors because of delays in fit-ups, (see paragraph 3.37).

3.37 Department of Public Works - Non-productive rental payments in excess of $7 million

To provide accommodation in Hull, Quebec, for federal employees, the Department of Public Works entered into a 10-year lease at an annual rental of approximately $9.2 million for 37,160 square metres of office space and 1,045 square metres of storage space. This lease was not entered into in accordance with the conditions directed by Treasury Board. This, in addition to the delays in occupying the building because of fit-up problems, resulted in non-productive rental payments in excess of $7 million to the end of June 1986.

3.38 In September 1983, the Department obtained Treasury Board approval to enter into a 10-year lease for an office building in Hull, Quebec. Treasury Board approved the acquisition of the space on condition that Public Works negotiate conditions in the lease agreement respecting occupancy and prorated rentals. It was specified that occupancy would not start until construction, building systems, and landscaping were completed and accepted by the Department, and public transportation to the building was available. Rental payments were to be prorated according to occupancy. In view of the short-term occupancy agreed to by the client (five to seven years), Public Works was also directed to consider negotiating a seven-year lease contract with a three-year renewal option, and incorporating a purchase provision in the lease contract as a long-term option.

3.39 Public Works attempted, but was unable, to obtain agreement from the developer to reduce the lease term, to secure a purchase option, or to establish a prorated rental arrangement. Instead, it entered into a lease at an annual rental of $9.2 million for 10 years commencing 1 June 1985, without advising Treasury Board that it was unable to meet the conditions that had been established.

3.40 In June 1985, Public Works was informed by the developer that the base building would be completed, including all systems and landscaping, by the end of August 1985, and full rental payments would start 1 September 1985. During the fall of 1985, Public Works refused to accept the building on the basis of concerns about the lighting, acoustics and security and fire protection systems. However, based on a consultant's report made to resolve this conflict, the Minister of Public Works subsequently directed that payments commence as of 1 September 1985.

3.41 Full rental payments were made from 1 September 1985, but because of delays in designing, completing working drawings, obtaining approvals and fitting-up the space according to the client's special requirements, occupancy of the building did not begin until the end of February 1986. As of June 1986, only about 20 per cent of the building was occupied. We estimate that non-productive rental payments to the end of June 1986 were in excess of $7 million. The Department expects the building to be fully occupied by the end of September 1986.

3.42 Department of Regional Industrial Expansion - Failure to enforce contract conditions

The Department of Regional Industrial Expansion (DRIE) authorized a contribution of $539,370 to a private company under the Innovation Element of the Industrial and Regional Development Program. In 1985-86, payments by DRIE totalled $216,000 bringing the total paid to the full authorized amount. These payments were made despite the fact that DRIE was aware of the ongoing substantial risk of project failure. In making these payments DRIE did not enforce certain provisions of its contract with the company that would have permitted the Department to withdraw from the project, thereby minimizing its losses. The company petitioned for bankruptcy shortly after receiving final payment from DRIE.

3.43 In June 1984, the Department approved a contribution of $539,370 to a private company under the Innovation Element of the Industrial and Regional Development Program (IRDP). The contribution was to assist the company in the development of an executive electronic work station.

3.44 In July 1984 the Department agreed to a request by the company to assign all contribution payments directly to a chartered bank on behalf of the company. A first payment of $210,353 was made in October 1984 and a second payment of $113,017 in March 1985.

3.45 Although it was aware that the company was in serious financial difficulty the Department made a further payment of $152,674 and a final payment of $63,326, in June 1985, bringing the total to the authorized amount of $539,370.

3.46 In August 1985 the company filed for bankruptcy and was declared bankrupt in December 1985. Because the Department is an unsecured creditor, its chances of any substantial recoveries are, in the opinion of the Trustee, remote.

3.47 Our review of the administration of this project revealed that the last two payments in June 1985, totalling $216,000, were made despite the fact that the Department was aware that the company might be in default of its contract with the Department. The contract contained provisions to protect the Department's investment and to permit the Department to withdraw from the project by terminating its obligations to continue to contribute to costs of the project in the event of default by the company. The Department made the payments without enforcing a number of provisions in the contract that would have removed the obligation to make these further payments.

- One clause permitted the Department to terminate its obligation to make future payments if, in the Department's opinion, a material adverse change in risk had occurred. We noted that the Department thought that such a change in risk had taken place.

- Another clause required the project to be completed on or before 31 March 1985. The last two payments were made after this date, although the project was not completed and the contract was not amended.

3.48 There was no analysis in the project file indicating why these contract conditions were not acted on prior to the June 1985 payments.

3.49 The contract also permitted the Department to obtain the rights to the technology to which it had contributed, in the event of default by the company. At the time of our audit, no action had been taken on this provision.

3.50 We also noted that the company had received a guaranteed loan from a chartered bank under the Small Business Loans Act in June 1985. In March 1986 the Bank filed a claim with the Department under this Act. The claim for $56,662 was paid in June 1986. This information was not disclosed in the IRDP project file. We learned of this additional assistance when reviewing central financial records of payments under all programs.

3.51 Our concern with the administration of this project is not that the project itself was unsuccessful. A program such as the Industrial and Regional Development Program is bound to have a mix of successes and failures. Rather, our concern is that the Department did not act on a number of contract provisions designed to protect its own interests. If such contract provisions are to be meaningful, they should be enforced, or the rationale for non-enforcement should be documented and approved at an appropriate level.

3.52 Department of Regional Industrial Expansion - Payment to avoid lapsing funds

> In order to avoid lapsing funds under the Special Recovery Capital Projects Program, the Department changed its pattern of cost-sharing with New Brunswick and made an additional payment of $1,764,700 in April 1985 which, in our opinion, it did not have to make at that time. We estimate that this resulted in interest costs to the federal government of approximately $61,000.

3.53 In September 1983, the Department and the Province of New Brunswick entered into a subsidiary agreement to fund jointly a pilot project to test a new process for extracting metal from ore. This $22,350,000 project, called the Sulphation Roast Leach Project, was approved as part of the government's Special Recovery Capital Projects Program (SRCPP) for which additional funds were provided to departments. DRIE's share amounted to $17,880,000, or 80 per cent of the total project costs.

3.54 On 10 April 1985, the Treasury Board advised departments that SRCPP was being terminated as of 31 March 1985. SRCPP projects and associated funds were incorporated into main departmental budgets. Payments in 1985-86 and subsequent years were to be made from the Department's previously approved spending levels.

3.55 At 31 March 1985 the Department had spent approximately $7.1 million of the $9 million in SRCPP funds allocated for 1984-85. In order to avoid having to fund the difference of $1.9 million from its own budget in 1985-86, the Department arranged in late April 1985 to have the Province claim up to 100 per cent of expenditures from the federal government for the 1984-85 year. The Province was asked to submit a claim for an additional $1,764,700. The Province did so, and the claim was paid on 25 April 1985 with the payment charged to 1984-85 funds. The credit of $1,764,700 was netted against future claims covering the period from 1 April 1985 to 30 September 1985.

3.56 The agreement with the Province permitted the Department to make interim payments of up to 100 per cent of claims submitted in order to assist with the interim financing of the program, if the Province so requested. There was no indication that this additional payment of $1,764,700 was to assist the Province with such interim financing.

3.57 The only rationale for the additional payment was the Department's desire to avoid lapsing SRCPP funds. All other claims had been cost shared on the basis of 80 per cent federal/20 per cent provincial.

3.58 The effect of this action is that the federal government incurred additional interest costs that we estimated at approximately $61,000, using the weighted average treasury bill interest rate.

Report under Section 11 of the Auditor General Act on Our Continuing Review of the Oil Pricing and Compensation Programs

3.59 As directed by the Governor in Council, the Auditor General has undertaken a continuing inquiry into the administration of expenditures of the Oil Import Compensation Program, beginning with the 1973-74 fiscal year. From 1978 to 1982, the inquiry also included an audit of the Petroleum Compensation Revolving Fund. Since 1982, it has covered the administration of the revenues and expenditures of the Petroleum Compensation Accounting process, of which the Oil Import Compensation Program is now an element.

3.60 Sections 65.11 to 65.19 of the Energy Administration Act provide authority for imposing a Petroleum Compensation Charge on domestic and foreign petroleum including foreign petroleum products for processing, consumption, sale or other use in Canada. Proceeds from the Petroleum Compensation Charge are credited to the Petroleum Compensation Account. Effective 1 January 1984, a designated portion of the Oil Export Charge revenue, under section 77 of the Energy Administration Act, was also credited to the Petroleum Compensation Account. Pursuant to regulations made under sections 72 and 75 of the Act, compensation or supplement is paid to importers of foreign crude oil; producers of new conventional oil, special old oil and synthetic oil; producers of oil-based petrochemical feed-stocks and farmers, fishermen, loggers and mine operators to offset the impact of the Petroleum Compensation Charge increase; and companies transferring crude oil from Montreal to eastern Canada or exchanging Canadian crude oil for foreign crude oil.

Audit Notes

3.61 On 28 March 1985, the Minister of Energy, Mines and Resources announced that the Government of Canada and the energy-producing provinces of Alberta, British Columbia and Saskatchewan had agreed to deregulate crude oil prices effective 1 June 1985. As part of deregulation, the Petroleum Compensation Charge and Oil Export Charge are no longer imposed. In addition, all compensation and supplements – New Oil Reference Price Supplements, Special Old Oil Price Supplements, Oil Import Compensation, Synthetic Crude Oil Price Supplements, Domestic Transfers Compensation, the Petroleum Levy Offset, the Primary Industries Levy Offset, and the Crude Oil Exchange Compensation – were eliminated, effective 1 June 1985.

3.62 As a result of administrative re-organization within the Department of Energy, Mines and Resources, the Oil Pricing and Compensation programs are now administered by the Energy Commodities Sector.

Petroleum Compensation Accounting Transactions

3.63 The following is a summary of the Petroleum Compensation Accounting transactions for the fiscal year 1985-86, with comparative figures for 1984-85:

	1985-86	1984-85
	(millions of dollars)	
Revenues		
Petroleum Compensation Charge	$ 1,067	$ 2,180
Oil Export Charge	26	28
	1,093	2,208
Expenditures		
New Oil Reference Price Supplement	470	1,854
Oil Import Compensation	243	700
Synthetic Crude Oil Price Supplement	150	626
Special Old Oil Price Supplement	44	212
Petroleum Levy Offset	28	17
Primary Industries Levy Offset	17	-
Domestic Transfers Compensation	5	42
Crude Oil Exchange Compensation	-	4
	957	3,455
Surplus (Deficit)	$ 136	$ (1,247)
Provided for by:		
Statutory appropriations	$ 500	$ 500
Supplementary appropriations	-	841
	500	1,341
Less: Amount lapsed	500	94
	$ -	$ 1,247

3.64 The cumulative deficit in the Petroleum Compensation Account from its inception on 1 January 1981 to 31 March 1986 is $1,498 million. The 1985-86 fiscal year contributed $136 million to reduce the cumulative deficit.

3.65 The deregulation of crude oil prices effective 1 June 1985 eliminated the Petroleum Compensation and Oil Export charges as well as all compensation and supplements for imports, exports and production (of oil and petroleum products) that took place after 31 May 1985. Revenues reported in the fiscal year 1985-86 include receipts of February and March 1985 Levies as well as the Levies collectible on inventories on hand at 31 May 1985 that flowed through the pipeline system subsequent to 31 May 1985. The decline in expenditures from $3,455 million to $957 million is primarily due to the fact that the current year's expenditures related to production and imports of oil and petroleum products for a two-month period ended on 31 May 1985. In March 1985, the categories of oil eligible to receive the New Oil Reference Price were extended to include oil from Canada Lands at Norman Wells, Northwest Territories, and the Department of Energy, Mines and Resources paid approximately $16 million during the year 1985-86. Compensation payments for Petroleum Levy Offset and Primary Industries Levy Offset increased during 1985-86 because the programs were introduced effective 1 December 1984.

Audit Report

3.66 We have examined the revenue and expenditure transactions of the Petroleum Compensation Accounting Process, including compliance with Part III.1 and Part IV of the Energy Administration Act, and regulations made by the Governor in Council pursuant to the Act for the year ended 31 March 1986. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances, except as explained under Audit Reservations.

3.67 In our opinion, except for the effect of adjustments, if any, that we might have determined to be necessary had we been able to satisfy ourselves with respect to the situations described below, revenue and expenditure transactions of the Petroleum Compensation Accounting Process for the year ended 31 March 1986 have been properly processed within the accounts of Canada, and these transactions have, in all significant respects, been in accordance with the authorities specified, applied on a basis consistent with that of the preceding year.

Audit Reservations

3.68 **Program administration audits not completed.** We are unable to determine what adjustments, if any, might have been required to revenues and expenditures as a result of program audits that have not yet been performed.

3.69 Audits of programs are performed by outside auditors as well as the staff of the Department of Energy, Mines and Resources. The outside auditors that report to the program staff include Revenue Canada - Customs and Excise, for the Petroleum Compensation Charge and Primary Industries Levy Offset; Audit Services Bureau and the individual companies' external auditors, for Oil Import Compensation; and the Auditor

General of Alberta, for the New Oil Reference Price and Special Old Oil Price supplement payments made to Alberta. Audits of the designated portion of the Oil Export Charge are performed by the National Energy Board.

3.70 Payments of $173.7 million and receipts of $383.8 million for transactions of fiscal years prior to 1984-85 have not yet been audited. The receipts audit is scheduled for completion in September 1986 and the payments audit will be conducted at the same time that the 1985-86 transactions are verified.

3.71 Audits of amounts paid or received during the last two fiscal years are still continuing and are scheduled to be completed by the end of the 1986-87 fiscal year. As of 31 July 1986, the unaudited amounts were:

Program	Amount paid or received	Amount not audited	% not audited
	April 1984 - March 1986	April 1984 - March 1986	
	(millions of dollars)		
Revenues			
Petroleum Compensation Charge	$ 3,247	$ 1,296	40
Oil Export Charge	54	54	100
Total Revenues	$ 3,301	$ 1,350	41
Expenditures			
New Oil Reference Price Supplement	$ 2,324	$ 883	38
Oil Import Compensation	943	2	-
Synthetic Crude Oil Price Supplement	776	776	100
Special Old Oil Price Supplement	256	32	13
Petroleum Levy Offset	45	45	100
Primary Industries Levy Offset	17	17	100
Domestic Transfers Compensation	47	47	100
Crude Oil Exchange Compensation	4	4	100
Total Expenditures	$ 4,412	$ 1,806	41

3.72 **Oil import compensation claims for May 1985.** Sufficient evidence was not available to establish the eligibility of five claims submitted under the Oil Import Compensation Program for the month of May 1985, and therefore we were unable to verify the eligibility of payments amounting to $3.9 million.

3.73 Under the Petroleum Compensation Regulations, import compensation was payable only for loadings that took place prior to 1 June 1985. The Department made compensation payments for some loadings that took place at the end of the Program based on provisional claims that were not supported with documents that would establish the loading dates. Audits of most of these claims have been completed, but the staff of the Department of Energy, Mines and Resources have not yet finalized the claims. Until bills of lading or other evidence are available to establish that loadings associated with these five claims occurred prior to 1 June 1985, we are unable to verify the eligibility of payments, amounting to $3.9 million.

Other Audit Observations

3.74 **Unpaid levies.** As of 31 March 1986, a total of $77.8 million in unpaid levies was owed to the Crown by three levy payers. Agreements have been reached to pay the outstanding balances over the next five to seven years.

3.75 **Court cases.** There are three court cases, with claims against the Crown amounting to approximately $6.5 million, that have not been resolved.

3.76 **Contentious cases.** As a result of audits, the Department of Energy, Mines and Resources has identified contentious cases of potential recoveries amounting to $10.1 million, but has not yet determined how these matters will be resolved.

3.77 Payments or recoveries that result from the outcome of these cases will be recorded under the Petroleum Compensation Account.

3.78 **Unfinished matters.** The administration of the Petroleum Compensation Accounting Process will continue in order to finalize outstanding audits and adjustments from it, adjustments arising out of the settlement of court cases, collection of unpaid levies, and payments under the Primary Industries Levy Offset Program.

3.79 Until we receive instructions from the Governor in Council to discontinue our inquiry, this Office will report annually as directed.

INCOME TAX EXPENDITURES

INCOME TAX EXPENDITURES

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4

INCOME TAX EXPENDITURES

The Tax Expenditure Concept

4.1 The income tax system in Canada has two broad objectives – to raise revenue and to serve other economic and social purposes. The tax expenditure concept results from the understanding that tax revenue foregone to serve these other purposes is equivalent to money spent through parliamentary approved direct expenditure programs.

4.2 **Raising revenue.** In raising revenue, the objective is to transfer control over real resources from private decision makers to the government, to provide the government with the capacity to pursue its policy objectives. Equity, efficiency and simplicity are the criteria that have come to be accepted in designing and assessing the income tax system as a revenue-raising mechanism.

4.3 Equity is considered to have a "horizontal" aspect, whereby everyone in the same circumstances pays the same tax, no matter what the source of income is, and a "vertical" aspect, whereby those in different circumstances incur appropriately different tax liabilities. The latter aspect is the basis of the progressive personal income tax rate schedule.

4.4 Efficiency requires that the tax system be structured so as not to distort the production, consumption, savings or investment decisions of private individuals or companies; that is, the system should be neutral. Where such distortions are inevitable, they should be minimized. This endorses the belief that private choices shaped by private preferences and market forces are socially efficient and should not be influenced by tax considerations.

4.5 Simplicity requires that the Income Tax system be clear so that taxpayers can use the provisions without incurring unreasonable costs and understand the tax implications of any course of action. This also means, for example, that provisions directed to small business should be simpler than those directed to multi-national corporations. The Act must be understandable because the system relies on voluntary compliance and self-assessment. In addition, simplicity is needed for ease of administration.

4.6 **Serving other purposes.** The second objective involves using the tax system as an instrument or set of instruments to pursue other economic and social purposes. Examples of these are general economic development, regional development, altering savings and investment patterns, and redistribution of income. This results in departures from a normative or benchmark tax system and gives rise to tax expenditures. The benchmark tax system is not one that necessarily should be enacted. Looking at a tax expenditure as a provision in the Income Tax Act intended to pursue any of these other economic or social goals provides us with a decision rule for distinguishing it from a feature of the normative or benchmark tax structure. We only need to ask whether it is necessary to the design of a revenue-raising system that adheres to the principles of equity, efficiency and simplicity or whether it is designed to pursue other economic or social goals. The goals that it is designed to pursue also give us a way of organizing and identifying the measure according to its aims, in the same way as the Policy and Expenditure Management System does.

4.7 The tax expenditure concept also illuminates the choices and dilemmas inherent in using the tax system in this way. The two distinct purposes of the system, which are both beneficial, are often at odds with each other. A tax expenditure may be important to attaining a desirable economic or social purpose but also make the system less able to provide equity, efficiency and simplicity. Elimination of the tax expenditure may improve the functioning of the tax system as a revenue generator, but at the cost of losing a possibly valuable instrument with which to achieve the other social or economic goal. When both objectives are desirable, difficult trade-off decisions must be made.

4.8 **Definition of tax expenditures.** The Department of Finance has defined and identified tax expenditures within the income tax system. They take the form of exemptions, deductions, credits, reduced tax rates, or tax deferrals. Conversely, tax penalties, which deny an exemption, deduction or credit, are imposed to discourage taxpayers from undertaking a particular course of action. Whatever the form, tax expenditures provide special tax treatment to selected individuals and groups in society.

4.9 Income tax expenditures can also be categorized as providing preferential treatment either to improve the ability-to-pay concept of the system or to encourage taxpayers to undertake a particular course of action.

4.10 In the first category, preferential treatment is based on the specific circumstances of the taxpayers themselves and is not intended to alter taxpayer behaviour. Thus these provisions do not generally have any impact on economic decisions in the marketplace but recognize different individual or family circumstances. Examples include the disability deduction and the age exemption.

4.11 In the second category, the provisions are generally designed to affect taxpayer behaviour. Examples include the Multiple Unit Residential Building (MURB) program, resource-related tax write-offs, preferential treatment of savings for retirement, donations to charity and investments in Canadian equities.

4.12 For example, the tax savings associated with charitable donations, estimated by the Department of Finance to be $515 million in 1983, represent the share of funds put up by the government. This kind of tax expenditure is comparable to direct spending programs that provide special subsidies to certain groups or activities, in that it diverts public resources to encourage a shift of private sector resources to the area to be assisted.

Purpose of this Review

4.13 Over the years we have called for action to improve the usefulness of the information that government presents to Parliament and thus improve the accountability of the government to Parliament. In our 1979 Report we outlined improvements needed in the form and content of the Estimates. We called for information on tax expenditures to enable consistent historical reporting, and suggested that the effects of selective tax cuts and transfers be disclosed in the Estimates. The Report illustrated how the failure to account for these effects can lead to understatements of program expenditures and of the total taxpayer resources directed to the favoured areas.

4.14 In our 1984 Report, we reported on the Scientific Research Tax Credit program. We also commented that nothing like the same attention that is given to direct expenditures has been given to tax expenditures. Mechanisms have been established for direct expenditures to measure economy, efficiency and effectiveness and to report on these matters to Parliament.

4.15 In our 1985 Report, our ongoing concern with the issue of tax expenditures, and specifically our emphasis on the fact that MPs are receiving insufficient information, was illustrated in our audit notes on the Hudson's Bay Oil and Gas Company Limited remission order and the tax implications of Petro-Canada's 1981 acquisition of Petrofina.

4.16 In surveying users' requirements for clear financial information on government operations during our Federal Government Reporting Study, we asked individual MPs about their need for information on tax expenditures. Their response was that it is generally impossible for MPs to evaluate the thrust of the government's social and economic policies unless they have such information.

4.17 Tax expenditures have become one of the major ways in which the government allocates resources, delivers incentives and influences private sector decisions. There is no precise information on the total annual value of tax expenditures in the income tax system but, to indicate their magnitude, we made an estimate. Based on the Account of Selective Tax Measures prepared by the Department of Finance in 1985 and containing information on 1982 and 1983, we estimate the amount to be about $28 billion annually.

4.18 Because of the increasing importance of tax expenditures, we believe it is time to identify the significant issues that grow out of their use. The fact that they fall into two categories clearly indicates that not all tax expenditures are similar and that they do not raise the same issues of management. This report is concerned with tax programs that are delivered through the income tax system and are designed to affect taxpayer behaviour. These programs are comparable to direct spending programs that provide special subsidies to certain groups or activities. We focus on four fundamental issues associated with such income tax expenditures:

- **The risks of using the income tax system.** We examined the risks associated with using the tax system as a vehicle for delivering programs.

- **The management of income tax expenditures.** We examined the management process and reviewed two tax programs – the Registered Home Ownership Savings Plan (RHOSP) and the Multiple-Unit Residential Building (MURB) program.

- **The income tax system and Crown corporations.** We examined how certain Crown corporations have made use of the tax system.

- **Information to Parliament.** We examined the adequacy and quality of the information presented to Parliament.

Risks in Using the Income Tax System for Delivering Programs

4.19 Our examination has led us to conclude that the Income Tax Act is a high-risk statute to use for delivering programs. The government's failure to act in a timely manner to eliminate identified taxpayer-induced avoidance mechanisms has caused hundreds of millions of dollars of revenue losses.

4.20 Our examination of the nature of the tax system led us to conclude that the risks are high in using the Income Tax Act to deliver programs. The inherent risks associated with tax spending, which may be present but not to the same degree in comparable forms of direct spending, are listed below and discussed in subsequent paragraphs:

- program costs are open-ended;

- there are "grandfathering" or closing costs;

- it is often difficult to focus on the desired target;

- taxpayers develop avoidance mechanisms;

- the tax administration process is designed to encourage taxpayers to comply with the Income Tax Act rather than to ensure that program objectives are met;

- a variation in the tax rate structure can change the effect of a tax measure;

- compliance problems have a negative impact on federal and provincial revenues;

- co-ordination of spending plans is hindered; and

- because costs are hard to monitor, budget control becomes difficult.

Open-ended Program Costs

4.21 Every taxpayer who complies with the incentive provisions in the Income Tax Act is entitled to the benefits; there are no cost limits or expenditure ceilings. For example, all taxpayers who contribute to a Registered Retirement Savings Plan are allowed to claim the contribution within certain limits. But the total amount of tax revenue foregone depends on how taxpayers respond. As a result, if more taxpayers make use of the provision than was deemed necessary to accomplish the original objective, the cost to government may be larger than anticipated. In addition, the provision can result in merely supporting activities that would have occurred without it and not creating additional activity. This risk of foregoing large amounts of revenue with little net gain in terms of creating additional activity is perhaps the greatest risk associated with tax expenditures.

4.22 Taxpayers can continue to claim a deduction, exemption or credit after the government's objective has been met. A provision cannot be withdrawn simply because the amount of tax revenue foregone has exceeded the amount originally estimated. This would cause uncertainty and unfairness, which are unacceptable in a modern tax system. Also, it is generally not possible to know the amount of revenue that will be foregone until tax returns are filed – up to 18 months after the provision is put into place. Thus the minimum cost of a tax expenditure is the cost of running the program until the first opportunity for review arises.

"Grandfathering" or Closing Costs

4.23 Because of the need for advance planning to take advantage of a tax measure, taxpayers should be protected against changes in the rules after a commitment has been made but before the transaction has been completed. The basic ground rules are that no transactions for which firm commitments have been made, and that are legal under the existing legislation, should be made illegal after the fact by legislation that has a retroactive effect.

4.24 Where tax measures have been changed to correct an anomaly or close off an unwanted tax expenditure, the legislation has usually contained a specific set of "grandfather" provisions to protect taxpayers who committed themselves under the old provisions. The result for the Treasury is that the expenditure is not stopped for some time. This results in further costs, where costs have presumably already outweighed the benefits.

4.25 The Department of National Revenue-Taxation (NRT) estimated in a statement to the Public Accounts Committee that the grandfathering cost of the Scientific Research Tax Credit program will be more than $1 billion.

4.26 When the RHOSP program was terminated in May 1985 the $2 billion in accumulated funds could be withdrawn free of tax for any purpose. The tax foregone on funds withdrawn for non-housing purposes represents a program closing cost.

Difficulty in Focusing on the Desired Target

4.27 A basic principle of Canadian income tax law is that a taxpayer is entitled to arrange his or her affairs to attract the minimum amount of tax. This right is subject, however, to specific and general statutory anti-avoidance rules. In addition, the Supreme Court of Canada has held that the provisions of the Income Tax Act must be interpreted in accordance with the "object and spirit" of the Act as a whole. Nevertheless, in certain circumstances taxpayers may be able to engage in legal transactions that have the effect of avoiding tax in ways that were not contemplated or intended by Parliament. The law and regulations must define as completely as possible who and what qualifies for particular measures. This breeds complexity and often cannot be done without imposing the same kind of case-by-case review normally associated with direct spending programs. The tax system is better suited to delivering broad-based reductions in rates or broad-based tax credits.

4.28 A great deal of care must be taken to prevent unintended use of preferential provisions to which taxpayers are entitled. In designing the legislation that provided for the lifetime $500,000 capital gains exemption, for example, the drafters had to be concerned about potential misuses, such as:

- converting capital gains of corporations that do not qualify for exemption into capital gains of individuals;
- increasing the tax value of a property through an arranged sale; and
- converting income to a capital gain.

4.29 As well as preventing undesirable uses, the tax system must counter steady attempts to circumvent the measures designed to prevent avoidance.

4.30 To ensure that tax incentives are not misused, benefits are usually not available unless taxable income is earned. Winners are favoured rather than losers. Misuse is controlled by requiring the taxpayer to share the risk with the government. The greatest risk to the government occurs when taxpayers are able to reduce their immediate risk by obtaining a tax benefit that significantly reduces their cash outlay, or by assuming little or no risk at all. The revenue drain associated with the Scientific Research Tax Credit was fuelled by taxpayers who bore little or no risk.

Taxpayer-induced Avoidance Mechanisms

4.31 It is both legitimate and advisable for taxpayers to seek expert advice to ensure that they minimize their tax costs. But although this kind of advice creates tax savings, it may subvert or greatly reduce the effectiveness of taxation provisions. Taxpayer-induced avoidance mechanisms were not intended by the program designers and legislators. Unlike tax expenditures, which give tax relief to taxpayers who have fulfilled conditions that further the government's specific economic or social objectives, these mechanisms do not relate to any specific objectives and are seldom seen as furthering the general intent of the legislation.

4.32 The flow of tax expenditures to corporations over the years has created a "pool of losses" and unused tax credits which the Department of Finance estimated had a tax value of $18.5 billion in 1982. As taxpayers and tax experts devise ways of converting this pool of losses into cash, the Minister of Finance introduces legislation to counter their efforts, which further complicates an already complex statute.

4.33 At present there is also a significant backlog of identified technical problems that have not been dealt with. The required amendments would provide more certainty and correct anomalies. The system, however, will have great difficulty absorbing the complexity the required amendments would cause.

4.34 **Measures to reduce avoidance.** It is virtually impossible to eliminate taxpayer-induced avoidance mechanisms. The legislative drafters and their advisers do not have the resources or the incentives of the private sector experts who devise them. To reduce their incidence the Department of Finance uses specific provisions designed for specific circumstances, which increases the complexity of the Act. Alternatively, the Department uses general anti-avoidance provisions which create uncertainty for taxpayers.

4.35 These avoidance mechanisms also have a negative effect on the equity and integrity of the tax system and on attitudes to voluntary compliance. Access to such mechanisms is usually restricted to those who can afford very expensive advice. Those who cannot may therefore be denied equitable or even-handed treatment.

4.36 It may be that, in some cases, such mechanisms enable taxpayers to make investments that benefit the nation as a whole and further the economic objectives of the government. But in other cases, tax benefits may attract investors who do not understand the merits or the full risks of a project. Ultimately, losses from unwise investments fall to the taxpayer and the economy.

4.37 Legislators usually have no control over or even knowledge of such avoidance mechanisms. Even the Departments of Finance and National Revenue - Taxation are often unaware of the mechanisms and their consequences until advance ruling requests are received or tax returns are filed and assessed.

4.38 **Limited partnerships.** Limited partnerships have been used for tax shelters for some time. In the 1960s, they were used for income splitting. In the 1970s, they were used for financing oil and gas exploration, and in marketing film tax shelters and MURBs. In the early 1980s, they were used in research and development tax shelters.

4.39 In 1983, limited partnerships began to be used as large depreciable asset tax shelters. In essence, this arrangement was designed to transfer the tax benefits associated with depreciable assets from one taxpayer to another without, in substance, transferring ownership of the assets. The following example illustrates how it might work.

- X corporation owns facilities and equipment with a tax value of $100 million that can be written off over two years. X corporation cannot use the tax write-offs.

- X transfers its facilities and equipment into a limited partnership. The partnership now has assets with a tax value of $100 million that may be written off over two years.

- X then sells limited partnership units to investors for $40 million cash and interest-bearing notes for $60 million due in 10 years.

- The partnership will now carry on the business previously carried on by X. Owners of X will guarantee the partnership an operating profit of $8 million a year for 10 years.

- Investors have the option of selling their partnership units to Newco (the general partner and a subsidiary of X) after 10 years for $65 million and the proceeds are used to repay the $60 million note.

4.40 The effect of such a transaction is that investors in the partnership receive a guaranteed tax benefit of $50 million (that is, $100 million of asset write-offs at a 50 per cent marginal tax rate) in return for an up-front payment of $40 million and an annual tax deductible interest expense in respect of the notes. The remaining $60 million, not due for 10 years, is offset by the $65 million redemption at that time. In all likelihood, the redemption would result in a taxable capital gain in the investor's hands. As well, the investors are to receive a guaranteed $8 million return on their investment each year over the 10-year period. On the other side of the coin, X receives $40 million in cash in return for write-offs which it cannot use.

4.41 As a result of these arrangements, including the available tax benefits, investors carry no significant risk of economic loss and little likelihood of any profit beyond the fixed return provided for.

4.42 As this type of arrangement emerged, the Department of National Revenue-Taxation provided in 1983 two advance income tax rulings for transactions that had been structured to come within its Interpretation Bulletin on the subject. NRT subsequently announced a clarification of its position in the Interpretation Bulletin which it believed would preclude further similar advance rulings. At that time, however, certain decisions rendered by the courts cast doubt on NRT's interpretation.

4.43 In 1984, the situation reached the point where NRT had received seven requests for advance income tax rulings, which would have represented a cost to the federal and provincial governments of approximately $1 billion. In view of this and the uncertainty in the law with respect to NRT's position, on 25 October 1984 the Departments of Finance and National Revenue-Taxation announced in a press release that advance income tax rulings would no longer be provided on limited partnerships.

4.44 On 14 November 1984, National Revenue-Taxation announced in a press release that in the interest of fairness and in order to provide transitional relief, advance income tax rulings would be available in certain cases denied under the October press release. An advance ruling with an estimated foregone revenue cost of $225 million that was denied under the October press release was issued under this press release.

4.45 While advance rulings were not available, this did not preclude transactions using limited partnerships. Completed transactions could be challenged by National Revenue-Taxation where they had gone beyond the Department's interpretation of the law. It was becoming obvious that changes in legislation were needed if the federal government wanted to put an end to the practice.

4.46 A notice of ways and means motion in February 1986 proposed that the amount of tax benefits flowing out to an investor be limited to the amount of the investment "at risk". The proposed legislation contains the usual grandfathering provisions, so that certain partnerships already in business will not be subject to the "at risk" rules.

4.47 The government concluded that use of limited partnerships to convert a company's unused tax losses into cash by selling them to passive investors resulted in the tax system providing an unintentional benefit. We have been unable to determine revenue losses to the government associated with this benefit, but it would not be unreasonable to estimate that it amounted to hundreds of millions of dollars. One of the most difficult problems in evaluating and monitoring the use of limited partnerships is the lack of information. They are not required to file an income tax return, and National Revenue-Taxation can only examine them by examining and consolidating the returns of each member.

4.48 **The "Little Egypt Bump".** The limited partnership example shows how taxpayers can make imaginative use of existing income tax provisions to reduce tax. Combining unrelated provisions of the Income Tax Act can also produce results that were not envisaged by the legislative drafters. This occurred in the mechanism that has come to be known as the Little Egypt Bump. This is one of a few celebrated schemes in which the revenue loss to the Crown was substantial when corporations arranged their transactions to make use of more generous partnership provisions. The extent of the revenue loss is not known but, based on the cases we examined, we estimate it to be in excess of $1 billion.

4.49 When an entity is sold, the price is based on the underlying fair market value of the assets acquired. A change in ownership, however, does not result in a revaluation of the underlying assets for tax purposes. To reflect the higher value of the assets recently purchased or to "bump up" their cost for tax purposes, the new owner is required to wind up the acquired entity. If the entity being wound up is a corporation, the bump-up does not produce increased tax write-offs; if it is a partnership, it does. This treatment was especially significant where oil and gas properties were involved. Thus corporations went through a complex series of interrelated transactions to take advantage of the partnership rules.

4.50 In December 1985, the government brought the partnership bump-up provisions into line with the corporate provisions. Legislative changes were designed to ensure that corporate takeovers involving a bump-up would not produce additional tax write-offs.

4.51 Where Canadian companies were the two parties to the transaction, the tax revenue loss related to the additional write-offs obtained by the purchaser on the bump-up would be offset to a certain extent by the tax revenues realized by the government on the share sale. If the vendor was a non-resident, however, the tax revenue loss would not be offset where the non-resident was exempt from Canadian tax under an income tax treaty.

4.52 As we reported in our 1985 Report, Petro-Canada's acquisition of Petrofina was structured to provide Petro-Canada with a bump-up and to ensure that Petrofina's non-resident owner was exempt from Canadian tax under the Canada-Belgium Income Tax Convention. The December 1985 legislative changes did not deal with the fact that transactions can be structured using the tax free rollover provisions and under certain conventions exempt non-residents from Canadian tax.

4.53 **Summary.** Taxpayer-induced avoidance mechanisms are sometimes identified but not corrected until the Crown has sustained significant revenue losses. It is impossible to determine the revenue losses associated with these mechanisms, but it would not be unreasonable to estimate that they could amount to hundreds of millions of dollars.

4.54 **The government should act in a timely manner to eliminate taxpayer-induced avoidance mechanisms when they are identified.**

Design of the Tax Administration Process

4.55 The Department of National Revenue-Taxation's mandate is to administer the Income Tax Act. In carrying out its mandate, NRT emphasizes compliance with the rules in the Act. Auditors at NRT do not have the mandate to gauge the effectiveness of spending programs and are not necessarily the most appropriate people to do so.

4.56 Direct spending programs are designed to achieve stated departmental objectives. However, National Revenue-Taxation has aims that are separate from those of the spending programs it administers. For example, it does not have an overriding concern for the stewardship of the country's energy resources. NRT personnel have no incentive to accomplish the objectives of tax-spending programs designed to encourage oil and gas exploration. The incompatibility between the objectives of tax expenditure programs and those of NRT can add to the difficulties of making such programs succeed.

4.57 Also, in addition to concentrating on collecting taxes efficiently under the revenue-raising provisions of the Act, National Revenue-Taxation must devote considerable time and effort to verifying eligibility and pursuing litigation for a multitude of spending programs. The problems associated with the Scientific Research Tax Credit clearly illustrate how tax expenditures can embroil NRT in issues that have nothing to do with revenue raising.

Effect on Tax Measures of Variations in the Tax Rate Structure

4.58 A modification of tax rates for whatever reason automatically alters the value of income deductions and exclusions to taxpayers. As a result, the activities fostered by income tax programs become either more or less attractive, depending on the nature of the rate change. Similarly, increases in the level of personal exemptions can cause unintended elimination of incentives by decreasing a taxpayer's liability below that necessary to make use of the special provisions. Provincial government initiatives could also make a particular federal program either more or less attractive.

Negative Effect of Compliance Problems on Federal and Provincial Revenues

4.59 Abuses or inefficiencies in a tax program can erode the revenue-generating capacity of the tax system by compromising its integrity. Not only does this result in an unnecessary loss of revenue, but it reduces the public's confidence in the fairness of the system, which may then lead to increased levels of non-compliance. The resulting losses are magnified when the effect they have on provincial revenues is considered.

4.60 A badly designed tax program can also have an unintended negative effect on provincial revenues. The refundable tax in the SRTC program was designed to eliminate the government's cost of the credit in situations where the research and development was not carried out. The refundable tax is 50 per cent of an amount designated by the researcher and goes to the federal government. For individual investors, the federal portion of the SRTC was 34 per cent of the amount designated and the provincial portion was calculated at the applicable provincial rate.

4.61 As National Revenue-Taxation's monitoring of the program has shown, some researchers were unable to carry out the research and development required to extinguish their refundable tax liability. Consequently, NRT has taken steps to collect the tax. In these cases, the provinces will indirectly provide the federal government with a subsidy equal to the difference between the refundable tax collected and the amount of the federal tax credit given to the individual investors. This amounts to $16 for every $50 of refundable tax collected.

Hindered Co-ordination of Spending Plans

4.62 The use of tax expenditures can impede government budget-planning efforts. Under current practice, when spending programs are placed in the tax system, they are removed from the normal budgeting process that applies to all direct outlays. For example, tax expenditures are not covered by the detailed spending targets that guide legislative consideration of direct spending options. In this way, funds spent through the tax system are insulated to a significant degree from explicit competition with other spending priorities for scarce budget dollars. But because this competition is the mechanism by which the relative values of alternative spending options are determined, it lies at the heart of effective budget design. Thus, delivering programs through the tax structure hinders the government's ability to assess accurately the value of such programs relative to other needs. This obstructs the formulation of a co-ordinated and consistent budget plan.

Difficulty of Budget Control

4.63 Tax expenditures make control over government spending more difficult because funds spent through the tax system are harder to monitor than those disbursed through direct assistance schemes. Direct spending, whether accomplished through programs with spending ceilings or through open-ended entitlements, is highly visible. Unplanned increases or decreases in expenditures for particular programs can be rapidly identified by the specific department responsible for the payments. Desired program adjustments can then be quickly implemented.

4.64 By contrast, changes in individual tax expenditures are reflected only in fluctuations of total revenue collections. This makes the effect of such changes extremely difficult to identify and control because using the tax system to deliver incentives usually does not involve bureaucratic pre-approval of each transaction. As a result, the government may not be able to respond effectively to unanticipated and undesirable tax spending program developments.

Managing Tax Expenditures

4.65 Managing tax expenditures involves applying appropriate pre-implementation and post-implementation procedures. We concluded that, because the Department of Finance does not subject tax programs to appropriate pre-implementation and post-implementation procedures, it does not adequately manage tax-delivered programs.

4.66 We looked at the management process and reviewed two tax programs – the Registered Home Ownership Savings Plan (RHOSP) and the Multiple-Unit Residential Building (MURB) program. These programs were widely known to the public and were both directed to housing, an important economic sector. As well, both programs are substantially finished, giving us the opportunity to review their design, monitoring and evaluation. The Department of Finance does not have a documented history of the management of the programs.

4.67 RHOSP, introduced in 1974, enabled taxpayers over 18 who did not own a home to contribute up to $1,000 a year, to a lifetime maximum of $10,000, to a registered plan. Contributions were tax deductible and the income earned by the plan was tax exempt. Contributions could be withdrawn free of tax if they were applied toward the purchase of a house or in certain cases, furnishings. The top-up revisions to the RHOSP introduced in April 1983 allowed taxpayers acquiring a newly constructed home to bring the lifetime deduction up to $10,000. This deliberately changed the emphasis of the program from providing a savings mechanism for downpayment to stimulating short-term demand and reducing future savings. The program was terminated in 1985, and funds in existing plans at that time could be withdrawn free of tax for any purpose.

4.68 MURB was introduced in 1974 and ran to 31 December 1981, but was not available between January and October of 1980. Owners of certified multiple-unit residential buildings constructed during the period and used for renting are permitted to deduct capital cost allowance against income from any source. Canada Mortgage and Housing Corporation (CMHC) certified a MURB development if 80 per cent of planned floor space was residential and construction was started within a specified time.

4.69 RHOSP and MURB were both used to pursue private market housing objectives as opposed to social assistance objectives.

4.70 We looked specifically at the following, which we consider essential questions to be asked about any program.

Pre-implementation:

- Were consultations held during this phase with other government departments involved in the housing sector?
- Were alternative program delivery modes considered?
- Were the effects on existing programs with similar objectives considered?
- How were program costs and results forecast?
- Were program targets in line with their objectives?
- Who was responsible for the program?

Post-implementation:

- How were the programs monitored?
- How were the programs evaluated?

Pre-implementation Measures

4.71 **Were consultations held during the pre-implementation phase with other government departments involved in the housing sector?** When a tax program is introduced in a budget, preparatory work is restricted by budget secrecy though this tradition has been evolving over time. As a result, line departments with considerable expertise in a particular area may not be involved at the program development stage.

4.72 Since CMHC has the analytical capability and is set up to administer, monitor and evaluate housing programs, it would appear to be the best agency to deal with the interrelationships among direct and tax programs in this sector. Although it did not have a significant role at the program design stage of RHOSP it was involved in the design of MURB.

4.73 **Were alternative program delivery modes considered?** Finance officials were aware of the alternative housing or macro-economic instruments available. The Department of Finance could not provide us with evidence of a systematic process or of selection criteria that would lead to the particular program choice, either at the time the programs were introduced or when they were amended.

4.74 Finance was also not able to provide us with evidence that an in-depth review of alternative delivery modes was undertaken at the program proposal stage, or that the issue of value for money played a key role in the choice of instrument.

4.75 **Were the effects on existing programs with similar objectives considered?** At the time RHOSP and MURB were introduced and during their life cycle, four programs directed to the housing sector were being delivered by CMHC. The Assisted Home Ownership Program and Canadian Home Ownership Stimulation Program were designed to assist home ownership, and the Assisted Rental Program and Canadian Rental Supply Program provided rental assistance. No evidence was provided by Finance of an internal process to maximize the positive effects of the tax programs by co-ordinating them with these government initiatives. We were therefore unable to assess whether the possible effects of the interaction of programs were adequately considered.

4.76 **How were program costs and results forecast?** In the mid 1970s the tax expenditure concept was in its infancy. There was little analytical capacity to forecast the results of tax expenditures. Forecasting can be difficult when a program is first introduced or when many other influences, both general economic conditions or other government initiatives, are changing over a short time period. Finance did prepare estimates of program take-up which turned out to be fairly accurate, but there was no record of the methodology used or of the basis for the estimates.

4.77 Although reliable cost estimates are important, projecting results is an equally important forecasting exercise.

4.78 To do this it is critical to establish first what would have happened in the absence of the program. Much of what appears to be caused by the program might have occurred without it. The net effect of the program might be small in relation to the foregone revenue. For example, RHOSPs were designed to help young families save for a home. But presumably some families who were going to save for a home anyway took advantage of the program. In addition, taxpayers could use the program solely to defer income taxes.

4.79 At the early stages of RHOSP the essential forecast was the net amount of savings induced. When the objective changed the issue became the amount of additional demand for new homes that it generated.

4.80 At the more general level of analysing housing programs and forecasting their results, two issues are critical: to what extent can supply be influenced, and what is the long-term effect of temporary stimuli? The answer to the first question determines the limits for intervention, and the second indicates the expected returns. Although officials recognized these important issues, we saw no evidence that program results were forecast.

4.81 **Were the program targets in line with their objectives?** The first step in targeting programs is defining clear and measurable objectives. We concluded that the objectives for RHOSP and MURB were vague.

4.82 At the macro level, the early objective of RHOSP was to encourage saving for homes and reduce pressure on house prices. Later RHOSP came to be used as a direct stimulus with the top-up program for new home buyers. MURB was designed to increase rental housing supply.

4.83 The RHOSP and MURB program objectives illustrate the difficulty in precisely targeting tax measures to achieve an intended effect. While the RHOSP program was put in place in the hope that it would be a useful savings vehicle for the young, it would have been difficult to apply such a general tax measure only to people of a certain age group. Similarly, while part of the concern that prompted MURB was the need for increasing the supply of low-income housing, it had the objective of increasing supply generally. To target a MURB only to low-income housing would have been difficult and complex. To continually monitor the unit to ensure that it was being rented by a low-income earner and to revoke its MURB status if it changed to an owner-occupied unit would have required controls associated with a direct program. Direct programs are better able to accommodate such specific targeting.

4.84 At a general level, we reviewed how the programs focused on real beneficiaries as opposed to nominal beneficiaries. The nominal beneficiaries for MURB would be the investors or developers who responded to the tax measure, and the real beneficiaries would be the people with moderate incomes who would rent the units provided. There were two potential problems – that investors taking up the program would benefit according to their marginal tax rates, and that if the programs pushed up land prices, the major beneficiaries would not be the renters but the land owners. Because the potential program response was not mapped out and some objectives were poorly focused, the net anticipated benefits to real beneficiaries is not known.

4.85 **Who was responsible for the program?** The Department of Finance is responsible for program design and evaluation. Within the Department, responsibility for tax programs is diffuse. Although the Tax Policy Branch clearly has primacy in tax measures, RHOSP and MURB were both motivated by housing concerns and macro-economic objectives rather than by taxation needs. This required input from officials involved in Social and Fiscal Policy.

4.86 Designing programs appears to be done on an informal, task force basis and can involve several groups within Finance. The groups work together, and issues that arise are discussed and challenged internally. This is well suited to the budget preparation process, but it leaves unclear the responsibility for monitoring and evaluating the programs.

4.87 Finance designs tax programs and National Revenue-Taxation administers the provisions of the Income Tax Act that enable taxpayers to use the programs. This divided responsibility creates difficulties and may inhibit program designers from modifying the program if administrative problems surface during take-up.

Post-implementation Measures

4.88 **How were the programs monitored?** For these programs, the Department of Finance was relatively uninvolved in program delivery. The Department of National Revenue-Taxation in administering the Income Tax Act played the key role in program delivery.

4.89 NRT interpreted the relevant tax legislation and prepared Interpretation Bulletins in consultation with Finance and issued advance rulings. For the MURB program, CMHC issued a certificate qualifying a building as a MURB, indicating that footings had been poured, that it was a multiple-unit building, and that at least 80 per cent of the floor space was residential. Developers and other entrepreneurs were involved in delivering MURBs, particularly in offering projects to investors. Trust companies and other financial institutions were involved in delivering RHOSPs.

4.90 NRT is the primary data source on the use of MURBs and RHOSPs, but it does not interpret or evaluate this data except in relation to compliance problems.

4.91 CMHC indirectly monitored RHOSPs and MURBs because of its general responsibility for housing matters, but it regarded Finance as responsible, and RHOSP and MURB data are not published in Canadian Housing Statistics.

4.92 The Department of Finance obtained feedback on the programs through contacts inside and outside the federal government. These contacts helped to interpret the workings of RHOSP and MURB and identify problems.

4.93 The MURB program was renewed several times. There was no systematic review of whether progress had been made toward meeting previously stated objectives. The program objectives remained fairly constant, but they were too vague and general to allow for measurement. Since MURB was not intended as a permanent measure, we expected to find reviews of progress at renewal dates. We found no evidence of such reviews.

4.94 The programs had a number of problems, best described as monitoring problems, which are still unresolved or are only slowly being resolved:

- Tax data on activities under the programs are available only after a long delay.
- MURB projects accentuated compliance problems because of the difficulty of establishing which costs were "soft costs" that would be immediately deductible rather than being capitalized and depreciated. This compliance problem was

not fully resolved during the lifetime of the MURB program. It led to large auditing costs within NRT, which were not fully anticipated when the MURB program began and were never fully assessed or assigned to the program. In the four years ending 31 March 1985, National Revenue-Taxation spent approximately 92,000 hours auditing 5,101 files representing 492 MURB projects. Reassessments were required on 4,910 files or 96.3 per cent of the files audited. Taxable incomes were increased by $120.3 million. We consider this to be an alarmingly high proportion of reassessments.

- The ability of MURB investors to deduct soft costs provided them with a tax benefit in addition to the tax benefit the program provided. We are unable to determine if this was anticipated when the program was introduced.
- Once a building has been designated a MURB, it keeps the designation for tax purposes after sale, provided 80 per cent of the floor space remains residential. This will require ongoing monitoring.
- Many MURB projects were registered as condominiums and then rented. After claiming the tax benefits, some condominium owners are occupying units rather than renting them.

4.95 The most serious problem was that no one was monitoring for the purpose of eventually comparing results against objectives or establishing what the effects have been on housing, price levels and employment.

4.96 **How were the programs evaluated?** There were no formal evaluations of MURBs and RHOSPs within the Department of Finance or CMHC. In January 1982, an unsolicited study of the impact of the Assisted Rental Program and MURB on the Vancouver housing market was completed with the assistance of a grant from CMHC under its External Research program. The study concluded that MURB investors paid an average premium to acquire the investment that approximated the present value of their future tax benefits. The study found that MURB is an expensive subsidy that is ineffective as a housing assistance program. It is our understanding that the study contributed to the fact that the program was not renewed.

Management Procedures

4.97 The high-risk nature of the tax system as a program delivery mode demands that tax programs be subjected to management procedures that recognize these risks. The failure to do so represents a serious deficiency in the control over public moneys. Even so, it is important to recognize that there are limits to how the income tax system can be used to support economic and social objectives without exposing public moneys to undue risk.

4.98 At the program proposal stage it is critical to perform a review of alternative delivery modes if the issue of obtaining value for money is to play a key role in the choice of instrument.

4.99 It is considered prudent that direct spending programs be assessed as to their effectiveness in terms of achieving objectives; their efficiency in terms of their costs and benefits; their equity in terms of social welfare goals achieved; and their overall priorities in the context of a proper allocation of resources. We believe that tax expenditure programs should be assessed in the same way.

4.100 The Department of Finance should ensure that tax expenditures are subjected to appropriate pre-implementation and post-implementation procedures and that appropriate analysis, cost information and an evaluation framework are developed for this purpose. The Department of Finance should ensure that it has the required resources to carry out these procedures.

Program Evaluation

4.101 In our 1983 Report, we pointed out that the Department of Finance is the only major department that has not appointed a manager for program evaluation and has not established a program evaluation unit. In 1984, the Department responded to the Public Accounts Committee that in the course of modifying existing policies and tax measures, the Tax Policy and Legislative Branch does perform program evaluations. The Department cited several major reviews of the operation of the tax system that included an examination of the effectiveness of measures in achieving their goals and meeting tax policy objectives. We looked at four of these reviews.

4.102 The Department uses the word "evaluation" in a broad sense – normally to mean a review – whereas program evaluation is a well defined process. None of the evaluations we reviewed met the requirements of the Comptroller General's guidelines on program evaluation. The Department has no consistent policy or requirements for its own internal evaluation work but operates on an ad hoc basis for each evaluation.

4.103 The Department of Finance should ensure that tax-delivered programs are evaluated in accordance with the guidelines issued by the Office of the Comptroller General.

4.104 Where direct expenditure programs are used in combination with tax and other programs to accomplish government objectives in a particular area or sector, the participation of the managers of all delivery modes is required. Evaluations must be conducted in order to eliminate duplication and measure the net results. Taken individually, all programs may be effective; collectively they may fail to meet minimum performance requirements. Because of the intermingling of tax effects with direct program effects in certain areas, individual program evaluations may not be feasible, let alone meaningful. In this case, the logical approach is to proceed on a sectoral basis. But a successful sectoral evaluation requires the expertise of all players.

4.105 The Department of Finance, with the assistance of the Office of the Comptroller General, should play a lead role in establishing a government-wide

evaluation framework to ensure that when tax programs are used in combination with other programs, evaluations are conducted interdepartmentally.

The Tax System and Crown Corporations

4.106 Crown corporations that are technically defined as taxable Canadian Corporations are able to bypass the normal parliamentary budgetary processes and obtain additional funds through the tax system.

4.107 **Canadian National (CN).** In our 1981 Report, we noted that CN had received double benefits resulting from the failure to consider all significant financial implications of new legislation. CN's financial statements indicate that the Corporation claimed a reduction in income taxes otherwise due for 1978, 1979 and 1980 as a result of reducing taxable income for those years by applying losses from prior years. Part or all of these losses related to periods prior to 1 January 1978 when the Corporation's deficits were fully reimbursed by the Department of Transport under annual appropriation acts.

4.108 **Petro-Canada's acquisition of Petrofina.** In our 1985 Report, we reported on how the tax system contributed funds for Petro-Canada's purchase of Petrofina. Petrofina exchanged its assets for shares of a Petro-Canada subsidiary. This exchange ensured that the sale by Petrofina's non-resident parent would be exempted from Canadian income taxes, which we estimated to be $200 million. The assets were then transferred to a partnership enabling Petro-Canada to "bump-up" the tax basis of the acquired assets. On winding up the partnership, Petro-Canada would reap tax benefits that we estimated to be $250 million.

4.109 **Scientific Research Tax Credits.** We noted that certain corporations wholly owned and partially owned by the Crown used the Scientific Research Tax Credit program. These corporations received over $100 million through the SRTC program.

4.110 **Summary.** Income tax matters could be of significance in reviewing the operations of Crown corporations. The structuring of commercial transactions to obtain tax advantages may in substance be an indirect method of obtaining government funds that would not have been available through appropriations.

4.111 The confidentiality provisions of the Income Tax Act do not allow National Revenue-Taxation to disclose taxpayer information. The ability of Parliament to scrutinize the activities of Crown corporations may be hampered when pertinent tax information is not available.

4.112 The government should ensure that the confidentiality provisions of the Income Tax Act do not hamper Parliament's ability to receive all relevant information on Crown corporations.

Information to Parliament

4.113 Parliament urgently needs information on tax expenditures to carry out its twin roles of considering proposed legislation and holding the government accountable for the use of public resources.

4.114 We are concerned that Parliament is becoming isolated from the Canadian income tax system, which is more than just the Income Tax Act. There are regulations and remission orders approved by Cabinet, Interpretation Bulletins and Information Circulars prepared by National Revenue-Taxation, advance rulings issued by National Revenue-Taxation, collection and assessment procedures employed by National Revenue-Taxation, and decisions rendered by the courts.

Accountability Documents

4.115 A major function of government is to reallocate the nation's resources, through taxing, regulating and spending, in what it considers to be the best interests of Canadians. Also, through laws that govern or influence the terms on which market exchanges will take place, the government helps to determine or influence prices in the economy.

4.116 Through raising funds by taxation and expending those funds, the government reallocates resources to provide what it believes Canadians need. This includes services, such as defence and publicly financed health care, that might not be produced in the private market; subsidies and grants to producers and purchasers of goods; and benefits to groups with physical, social or economic disadvantages.

4.117 Three major sources of information are available to Parliament on the resource allocation and use process – the Fiscal Plan, the Estimates and the Public Accounts. The following is a description of these three documents and the information they provide. We also looked at the sources of information currently provided on tax expenditures.

4.118 **The Fiscal Plan.** The government's Fiscal Plan is part of the budget, or economic statement, presented by the Minister of Finance. It is based on projected revenues from existing or announced tax legislation and on planned expenditures. The forecast of expenditures takes into account the government's overall priorities and the funding of new initiatives, as well as the projected cost of existing programs.

4.119 A principal aim of the Fiscal Plan is to inform Parliament how the government proposes to reallocate the public's money among competing claims. It also indicates the size of the deficit and how it is to be financed. Because it is so crucial, the Fiscal Plan gets the full attention of Parliament.

4.120 **Although the Fiscal Plan purports to describe fully the government's reallocation of resources, it does not fully disclose the extent of reallocation through the tax system. Only information on new tax initiatives is provided.**

4.121 **The Estimates.** The purpose of the Estimates is to communicate to Parliament in detail the level and nature of the government's spending plans for the coming fiscal year. The Estimates reflect the expenditure plan presented in the Fiscal Plan.

4.122 The Estimates respond to the information needs of Members of Parliament, who must understand and assess them in holding the government accountable for its management of the public purse.

4.123 The Estimates have three parts. Part I is an overview; Part II becomes more specific, outlining spending according to departments, agencies and programs and containing the proposed wording of the conditions governing spending which Parliament will be asked to approve. Part III submissions, provided by each department and agency, give details of the department and its programs.

4.124 Like the Fiscal Plan, the Estimates do not disclose the planned extent of the government's spending through the tax system.

4.125 **Public Accounts.** The Public Accounts cover the financial transactions of the government during the year. They include the financial statements of Crown corporations and other government-related entities whose accounts are maintained separately from the accounts of Canada. They do not disclose the extent of the government's spending through the tax system.

4.126 Parliament's role in holding the government accountable for resource reallocation decisions becomes more difficult when the Fiscal Plan, the Estimates and the Public Accounts do not disclose government activities undertaken through the tax system. Costs are buried, and decision makers may thus assume that programs are less expensive than they are.

Tax Expenditure Information

4.127 Parliament currently receives information on tax expenditure programs from three main sources: budget papers, explanatory notes to Bills amending the Income Tax Act, and tax expenditure accounts. Members of Parliament can also obtain information on tax expenditures from sources such as National Revenue-Taxation's annual publication, Taxation Statistics, which are not tabled in Parliament.

4.128 **Budget papers.** Tax expenditure programs are introduced to Parliament through budget speeches. Budget papers, which include supplementary information and notices of ways and means motions, are tabled to provide background information. Recent budget papers have provided multi-year forecasts of the revenue effect of announced tax expenditures. In addition, consultative and similar type documents are from time-to-time made available. The amount of information provided varies significantly.

4.129 In the case of the Registered Home Ownership Savings Plan, information was limited to a description of the mechanics of how the program would work and an estimate of the revenue loss for the first fiscal year. A brief statement of the objectives of the program was included in the budget speech.

4.130 For the Scientific Research Tax Credit, a consultative document was tabled in the House summarizing existing tax programs designed to stimulate research and development and proposing changes to those programs, including introducing the SRTC.

4.131 **Explanatory notes to Bills amending the Income Tax Act.** In recent years the Department of Finance has prepared explanatory notes for proposed income tax amendments outlining the need for the amendments and sometimes indicating the effect they will have.

4.132 Part XII of the Income Tax Act, introduced in December 1979 and enacted in February 1981, imposes a tax on registered pension plans and on tax-exempt persons who derive income from the operation of mines or from oil and gas production on which they are required to pay a royalty to taxable persons. This was designed to prevent the use of tax-exempt intermediaries to circumvent provisions of the Income Tax Act.

4.133 The tax was introduced largely as a response to a 1979 tax-avoidance arrangement that involved a major Canadian company and 19 Canadian pension funds. Extensive discussions with representatives of the pension funds resulted in transitional provisions ensuring exemption from tax to December 1983 and thereafter a lower tax rate on properties acquired before the introduction of the change in December 1979.

4.134 In 1984, the pension funds requested that the legislation be amended to extend the period of exemption from the tax to December 1989. Amendments to the Act first proposed in June 1984 and subsequently enacted in December 1984 accommodated the request.

4.135 In our opinion, Parliament should have been advised that the legislation that extended the transitional relief to December 1989 was designed specifically to accommodate a group of 19 pension funds, at an identified revenue loss of approximately $5 million a year for a total of $30 million over the six-year period.

4.136 *Technical amendment targeted to Dome Petroleum.* In June 1981, Dome Petroleum acquired a 52.9 per cent interest in Hudson's Bay Oil and Gas Company Limited, with the balance being acquired in March 1982.

4.137 In March 1982, Dome indirectly disposed of certain of Hudson's Bay Oil's resource properties to three companies. Dome had previously advised the Department of Finance that National Revenue-Taxation would not provide them with a favourable advance ruling on the transaction. In the opinion of National Revenue-Taxation, the transaction was taxable under the provisions of subsection 55(2) of the Income Tax Act. In Dome's opinion, it was not. Estimates of the income tax liability related to the disposition were in the range of $300 million to $468 million.

4.138 In June 1984, a ways and means motion containing technical changes to section 55 was tabled in the House of Commons. The retroactive effect of some of these changes would have negated Hudson's Bay Oil's income tax liability on the disposition. The House recessed before the amendment could be enacted. On 9 July 1984, the government announced its intention to provide Hudson's Bay Oil with an order remitting income taxes pursuant to section 17 of the Financial Administration Act. The announcement stated that the remission order would address two concerns – the tax status of the resource property disposal, and the inability of Dome to deduct for income tax purposes the financing costs incurred by it in acquiring Hudson's Bay Oil. The remission order was issued on 5 February 1985 and addressed only the second concern.

4.139 In November 1984 in Bill C-7, the technical changes to section 55 that were originally introduced in June 1984 were reintroduced. The Bill was proclaimed law on 20 December 1984.

4.140 The retroactive change to section 55 was treated as part of a series of technical amendments to the Income Tax Act, when in fact it was specifically targeted to Dome. In our opinion, Parliament should have been advised that the retroactive effect of the legislation amending the provisions of section 55 was designed to accommodate Dome, by ensuring that the transaction described in paragraph 4.137 would not be taxable.

4.141 **Tax expenditure accounts.** In 1979, the government published the first tax expenditure account. This outlined the concept of tax expenditures and provided estimates of their impact on federal tax revenues. Updated accounts were published in 1980 and 1985.

4.142 These tax expenditure accounts were helpful in identifying the many established programs within the taxation system and estimating their cost in terms of foregone revenue for prior taxation years. However, the known benefits received, whether financial or social, were not identified.

4.143 As well, the information provided in these accounts was outdated. For example, in the 1985 account, the personal information provided was only up to 1983 and corporate information only up to 1982. Also, it was provided in different forms and classifications in the three accounts, making comparison among them difficult. There was no attempt to provide original budget estimates of the program costs to help identify cost overruns or underruns.

Need for Information

4.144 The Federal Government Reporting Study published in March 1986 by this Office and the United States General Accounting Office revealed that most users of government financial information need information on tax expenditures to give them a full picture of all government activities. Members of Parliament indicated that they were particularly concerned that the information they receive be clear, exact and reliable and that it provide them with a broad perspective of policies and programs. Information on both direct expenditure programs and tax expenditure programs would have to be provided to fill this requirement.

4.145 In assessing proposals for the reallocation of resources, Parliament should know the objectives behind them, the level of funding proposed, and past and projected costs for comparison purposes. In assessing operational aspects, including the potential for successful achievement of these plans, Parliament should know what programs and activities funds are to be used for, the type of resources required and how responsibility is to be assigned. After programs are in operation, Parliament should have enough information to allow it to compare performance with plans.

4.146 The failure to provide Parliament with appropriate tax expenditure information through or in conjunction with the Fiscal Plan, Estimates and Public Accounts has seriously hindered Parliament's ability to hold the government accountable.

4.147 Information on tax expenditures should be available at the time of the regular budgetary and spending review process. This includes providing regular information on their costs and effects.

4.148 Parliament cannot assess the impact of proposed income tax amendments if it does not receive all relevant information. Although tax professionals may know that a change in legislation has been targeted to a particular entity, Parliament may not.

4.149 The government should ensure that all relevant information is made available to Members of Parliament when Parliament is requested to enact technical amendments to the Income Tax Act.

Report of the Public Accounts Committee

4.150 On 26 June 1986, the Fourteenth Report of the Public Accounts Committee dealing with the Scientific Research and Development Tax Credit Program was tabled in the House of Commons.

4.151 The Committee believed that the Department of Finance was negligent in its management of the SRTC program. The program never performed as intended and emerged as a costly tax loophole. At last count the Crown faces uncollectible taxes in excess of $900 million.

4.152 The consultation process was neither well planned nor comprehensive and resulted in an unanticipated demand for SRTCs. The quick-flip procedure and inadequate definition of and control over qualifying research activity encouraged abuse, reduced the funds available for genuine research and created bad debts to the Crown.

4.153 The Committee believed that certain important danger signals were in evidence very early and that the Department of Finance failed to establish from the outset an evaluation framework that would enable it to be aware of and to respond to problems as they developed.

4.154 In the Committee's view, Parliament must be kept informed of changes in the interpretation of tax expenditure legislation and the estimated costs of every major tax expenditure program.

4.155 The complete Committee report, with its recommendations, is in Appendix C of this Report.

Department of Finance Response

The government believes that use of the tax system to achieve economic and social goals is appropriate and in many circumstances can offer advantages in providing incentives that are economically efficient and not subject to undue bureaucratic control. However, there are limits to what can be achieved through the tax system, and, depending on the kind and level of incentive, tax measures can have disadvantages such as those noted in the Auditor General's Report.

In recognition of the care required in using tax incentives to achieve economic and social objectives, the government has taken action to increase and improve its review and analysis of existing and contemplated tax measures. Resources devoted to analysing tax measures prior to introduction have been increased. Public discussion papers embodying this analysis (such as the May 1985 papers on the corporate income tax system and the corporate loss transfer system) are now published. Analytic papers such as Tax Issues in Agriculture (January 1985) dealing with the impact of the existing tax structure are also published.

The government recognizes that tax expenditures can add to the complexity of the tax system and may have results other than those originally intended. Thus it has moved to limit or eliminate a number of provisions - such as the Scientific Research Tax Credit - when analysis showed that these provisions were clearly not achieving economic or social objectives or were doing so at an unacceptably high cost. The RHOSP and MURB provisions analysed in the Auditor General's Report have been eliminated, and other recent changes have reduced income splitting possibilities among family members and cut back on tax shelters through leasing of yachts, recreation vehicles, hotels and similar property, and through limited partnership arrangements. The government has also moved quickly to shut down taxpayer-induced avoidance mechanisms such as the so-called "carve out" transactions, (which involved temporary transfers of producing properties from profitable energy companies to other companies with unused tax losses) lease inducement payments and the innovative use of trust arrangements.

In July of 1986, the Minister of Finance announced a comprehensive tax reform review involving examination of reduced tax rates and broader tax bases, and which will therefore require examining further reductions or elimination of tax expenditures.

As set out in the November 1984 paper (An Agenda for Economic Renewal), the government recognizes that a self-assessment tax system is less amenable to direct hands-on control and specific targeting of incentives than is the case with the expenditure system (as indicated in paragraph 4.83). However, several recently-introduced tax expenditure measures have been designed to require earlier provision of information to tax administrators and program designers than has been the case in the past. This kind of procedure can be beneficial to enhance ability to identify and respond to any problems, particularly if it does not impose undue burdens on taxpayers. For example, the special measure for northern employee travel and housing benefits proposed in the February 1986 budget takes the form of a deduction from income in determining taxable income rather than an exemption, so that the amount of the benefit and the number of taxpayers affected can be identified. This will facilitate both the analysis of this concession and its administration by Revenue Canada.

In many cases, the avoidance mechanisms referred to in the Auditor General's Report involve the transfer of losses, deductions, or tax credits from taxpayers who cannot use them immediately to those who can. The discussion paper entitled "The Corporate Tax System: A Direction for Change", released by the Minister of Finance with the May 23, 1985 budget, identified the basic source of the problem and suggested dealing with it by lowering up-front write-offs and tax credits as part of the tax reform process. As a first phase of corporate tax restructuring, action was taken in the February 26, 1986 budget to phase out the general investment tax credit and the inventory allowance, coupled with a lowering of the corporate tax rate.

The government seeks to act in a timely manner to identify unintended results of tax legislation, and to rectify problems through legislative action. While speedy legislative action is desirable, before legislating it is essential to determine the nature and extent of the problem and to ensure that the response is appropriate, administratively feasible, and achieves the desired result. Performing such analysis means there often will be a lag between identification of an issue and the introduction of remedial legislation, particularly if undesirable and unintended consequences of the remedial legislation are to be avoided and appropriate transition rules are to be put in place.

In some cases the nature of the remedial solution to an identified problem may be more quickly evident. In a case such as the limited partnership rules cited in the Report, and in more recent cases in 1985 (such as carve-outs, lease inducement payments, the innovative use of trust arrangements to obtain investment income tax free and mechanisms to circumvent the foreign investment limits on pension funds) the government did act quickly. In the former case, which posed a number of complicated issues, advance tax rulings were suspended to ensure that the results sought by taxpayers were not guaranteed by government. This action was a deterrent to public offerings pending working out the legislative proposal. The government moved within a reasonable time to propose legislation. In the latter cases legislative solutions were proposed to Parliament soon after the problems became evident.

The Department is moving to increase the amount of formalized evaluation of tax measures including the establishment of a unit responsible for evaluating selected tax expenditure measures. The focus of this group will be to provide more extensive analysis of the impacts and effects of tax measures. While the Department believes that additional analysis is desirable, it recognizes, as does the Report of the Auditor General in paragraph 4.76, that *precision in forecasting the results that can be attributable to a measure after the fact can be very difficult. This is particularly the case when a variety of other economic conditions or government policies are changing. When tax measures are being evaluated, appropriate account will continue to be taken of related non-tax programs.*

Regular publication of tax expenditure information is desirable, and the Department is moving to enhance the amount and timeliness of information now provided on the costs of existing tax expenditure measures, subject to the need to avoid undue reporting burdens on taxpayers. It is recognized that there are some limits to the timeliness and accuracy of information on tax expenditure measures given lags in collecting tax data and the fact that information will continue to be based on estimates. The Department will continue to publish papers from time to time (such as the recent papers on corporate taxation) which provide information on effects of tax measures and will examine what additional information can be made available once the evaluation unit is in operation.

Provision of relevant information on tax amendments to Parliament and the public is essential, and the Department is exploring ways to increase the amount and clarity of information available for legislative amendments. However, it is neither practical nor desirable to publish detailed information on specific taxpayers affected by a budget tax measure, given that almost all measures are designed to be general in application and thus could affect a number of taxpayers not all of whom may be known. Such disclosure would also have the perverse result of discouraging taxpayers from providing information to government on how the tax system affects them, particularly in circumstances where such disclosure might lead to competitive disadvantages.

In general, information on the estimated revenue impact of selective tax measures should be made available at the time measures are proposed to Parliament. In some cases, because of the nature of the proposal, it may not be feasible to give a very precise estimate. In cases where purely technical amendments are proposed to ensure that the effect of the law conforms with previously stated policy, it may not be appropriate to provide separate estimates of revenue impacts, as the effect of the policy on revenues has already been taken into account in preparing the government's revenue projections.

With respect to Crown corporations, the current policy under the Income Tax Act is based on the principle that certain designated Crown corporations are commercial in nature and do compete, or potentially could compete, with private sector enterprises. These Crown corporations are subject to the same tax rules as other privately-owned corporations. As such, it does not appear appropriate for these corporations to be subject to separate tax treatment or separate disclosure requirements that do not apply to their competitors, and that could thus place them at a disadvantage.

With respect to section 55 of the Act, as indicated in the technical notes to the change placed before Parliament in 1984, the amendments to this section were made to correct what was believed to be an anomaly in the working of the provision. The amendments did respond to a number of representations that had been received, including the Dome case. As such, the government believed it was appropriate that a relieving amendment such as this, while proposed to Parliament in 1984, should apply to previous years in order to deal with the identified problems in the application of the rules from the time that the deficiency was introduced.

In addition, the government believed that, without the amendment and the remission order that also was provided, the Dome debt restructuring would not have *proceeded, with the result that there would have been serious financial implications for the company, the financial system and the economy and thus for the federal treasury. In the circumstances it must be questioned that the amendment represented a significant cost, if any, to the federal government.*

YEAR-END SPENDING

YEAR-END SPENDING

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5

YEAR-END SPENDING

Overview

5.1 For many years, Members of Parliament and the public have expressed concern about the spending of large amounts of taxpayers' dollars in the final weeks of the fiscal year. There is a perception that the government goes on a spending binge at year end and that millions of dollars are wasted.

5.2 To address this concern, we carried out a study with the objective of determining whether there was extra cost to the taxpayer because of spending at year end. We examined a sample of 1984-85 year-end transactions. We found, in general, that year-end expenditures were made on items that were within documented specifications and for which there was a defined need. But we also found instances where expenditures were made in advance of need or before the due date. Based on the results of our sample, we estimated that this spending resulted in an extra cost to the taxpayer of approximately $3 million in storage and foregone interest costs. This relates to about $46 million worth of equipment and supplies purchased in advance of need or before the due date. Included in the estimate of $3.0 million is $1.5 million under the Special Recovery Capital Projects Program, a special economic recovery program that by its nature resulted in advanced spending and an additional cost to the taxpayer. Thus, our findings show that, although there is an extra cost to the taxpayer associated with spending at year end, it is of much less dollar magnitude than generally perceived.

5.3 We also found three methods used by departments and agencies to avoid lapsing funds. We found cases where transactions were recorded in the current year that should have been recorded in a future year, contracts were amended as the year end approached to change the point of delivery of goods so that title could be obtained before the year end, and payments that would normally be made in a future year were moved forward to the current year.

5.4 The conclusion reached for the 1984-85 year end cannot necessarily be applied to other year ends, because each year can have a particular set of circumstances. For example, an event such as a staffing or expenditure freeze or a program to stimulate the economy such as the Special Recovery Capital Projects Program could have a considerable effect on spending patterns.

5.5 Departments and agencies receive money by way of appropriations which provide the authority to make expenditures out of the Consolidated Revenue Fund. Unless otherwise provided, appropriations lapse at the end of the fiscal year for which they were approved. The lapsing of funds policy is a basic principle underlying parliamentary control of public money.

5.6 The lapsing of funds policy has an important effect on the way departments budget their expenditures. The nature of the budgetary system encourages managers to withhold a portion of discretionary expenditures until late in the fiscal year to retain enough flexibility to deal with unexpected events or needs. In the private sector, getting the job done while coming in under budget is rewarded as good management. In the public sector, it appears that this lapsing policy exerts pressure on managers to spend in order to avoid lapsing funds. Thus they perceive that there is an incentive to spend all available funds in the current year to avoid being 'penalized' the next year by having their budgets cut or being required to absorb spending postponed from a previous year within a budget level that has already been set for the next year.

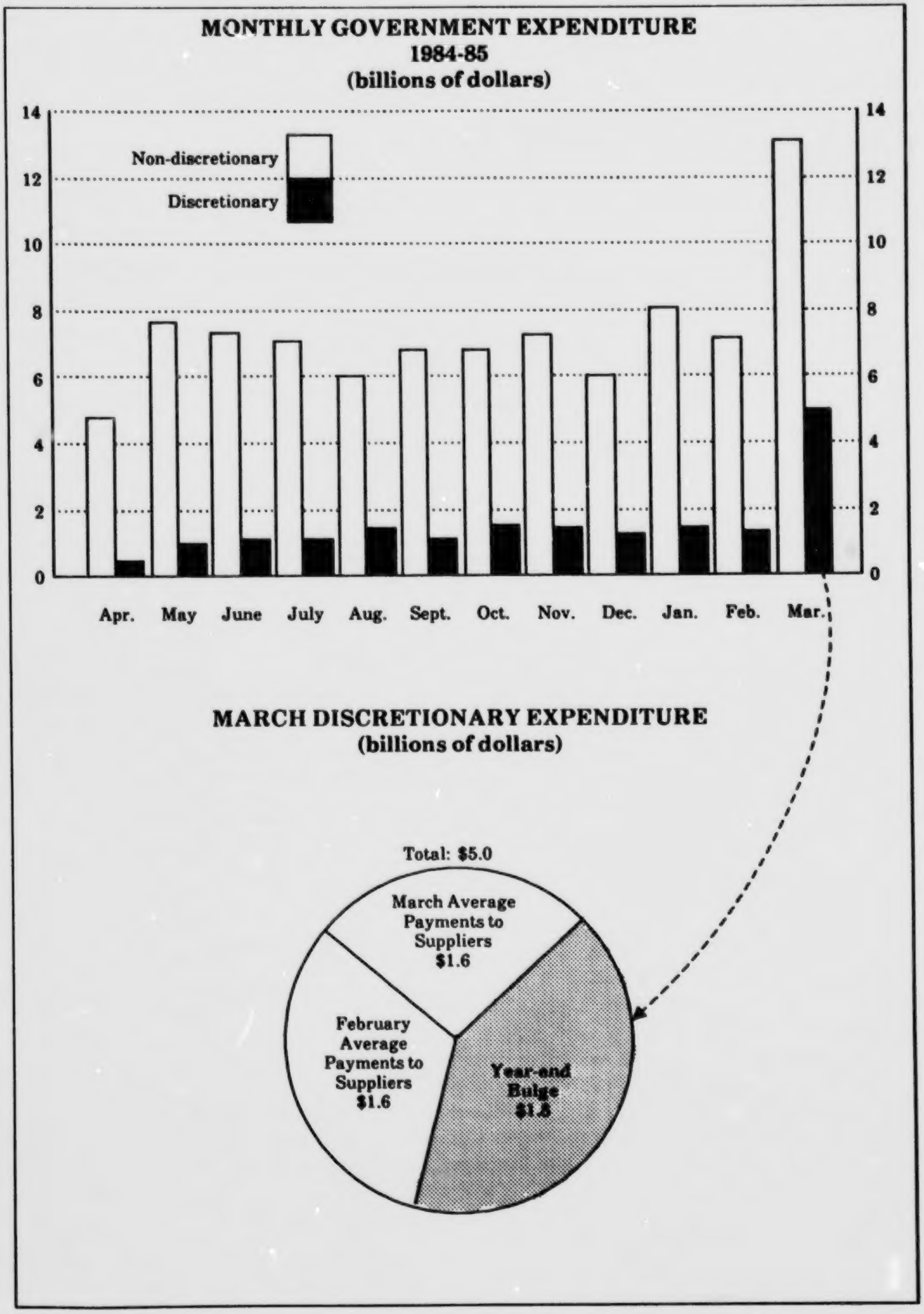
5.7 We interviewed a number of executives in the public service when we wrote Constraints to Productive Management in the Public Service (1983 Report, Chapter 2). These executives cited lapsing funds as a disincentive to productive management and stated: "There is some stigma attached to 'lapsing' funds at the end of a fiscal year, because this may be taken as an indication of a manager's inability to budget properly, and could reduce budget levels in future years. This is a disincentive to 'return' non-essential funds and an incentive to spend them, whether value for money is obtained or not." We considered lapsing funds as one of the top ten constraints to management as reported by public service executives and summarized their views as follows: "Funds that are authorized but are not spent by the end of a fiscal year cause problems for departments with large capital projects because of the 'lapsing' requirement." However, the lapsing of funds, while viewed as a constraint by managers, is a basic principle of parliamentary control.

5.8. We believe that the lapsing of funds policy is a major reason for the estimated extra cost to the taxpayer of approximately $3 million at the 1984-85 year end. There is a particular problem where multi-year acquisitions or projects are involved. The Office of the Comptroller General has advised us that the Treasury Board is investigating the concept of multi-year spending authorities in certain types of cases to determine whether improvements to the current policy of annual lapsing of funds are possible.

5.9 As part of the audit we analysed and charted spending patterns for 1984-85 based on information from the Government of Canada's monthly summaries of spending by type of expenditure. These summaries are prepared by the Department of Supply and Services. Exhibit 5.1 shows the monthly breakdown between discretionary and non-discretionary spending for 1984-85 and the "bulge" in discretionary spending at year end. For the purposes of our study, we defined discretionary expenditures as those expenditures over which the department or agency has a significant amount of control – such as professional and special services and construction and acquisition of machinery and equipment – as opposed to statutory payments such as fiscal transfer payments to the provinces and public debt interest payments.

5.10 Exhibit 5.1 shows that both non-discretionary and discretionary expenditures increase at year end. One of the reasons for this increase is that, for the most part, expenditures are recorded on a cash basis; that is, when they are actually paid. For example, March expenditures include payments made to suppliers and contractors for goods and services received in the month of February, because payment terms are usually 30 days after receipt of goods and services. At year end the accounting records are held open to record

Exhibit 5.1



MONTHLY GOVERNMENT EXPENDITURE
1984-85
(billions of dollars)

MARCH DISCRETIONARY EXPENDITURE
(billions of dollars)

payments to suppliers and contractors for goods and services received in the month of March, payables at year end, and any accounting adjustments that may be necessary at year end. These additional transactions, when added to the regular March expenditures, tend to exaggerate year-end spending figures. In Exhibit 5.1, "March" includes transactions for the month of March and the additional transactions noted above. In the month of April, the first month of the 1984-85 fiscal year, expenditures are low because April does not include payments to suppliers and contractors for the month of March. These payments have already been accounted for in March of the previous fiscal year (1983-84).

5.11 Total expenditures for 1984-85 amounted to $107.6 billion. The monthly average of these expenditures, both discretionary and non-discretionary, was $9.0 billion; however, expenditures recorded in March alone were $18.4 billion. Exhibits 5.1 and 5.2 show a breakdown of these "March" expenditures between non-discretionary spending – $13.4 billion – and discretionary spending – $5.0 billion – at the end of the year.

5.12 The $13.4 billion of non-discretionary expenditures was made up, as the name implies, of expenditures over which departments had little or no discretion. We found that the increase in non-discretionary spending was due mainly to payments scheduled to be paid in March or recorded on an accrual basis at the year end. For example, under several federal-provincial transfer programs such as equalization and post-secondary education, the final payment for a particular fiscal year must be made to the provinces on or before 31 March. These payments are usually made on 31 March.

5.13 The remaining $5 billion, then, falls into the category of "discretionary expenditures at year end". During the year, the average monthly discretionary expenditures were $1.6 billion. At year end, discretionary expenditures exceeded this average by $3.4 billion. As noted previously, these year-end expenditures, however, actually record the expenditures for two months, because payments to suppliers and contractors for goods and services purchased in February and March are included. Therefore, because two months of payments are included, the true discretionary "bulge" at year end, which we described as the excess of year-end expenditure over the average monthly expenditure, is approximately $1.8 billion.

Audit Scope and Criteria

5.14 The objective of our study was to determine whether there is extra cost to the taxpayer because of spending at year end. We defined the term "extra cost to the taxpayer" as describing situations where there was little regard for spending taxpayers' dollars wisely when making spending decisions. Some examples of the kinds of extra costs included in our definition were items purchased for which there was no defined need; exceeding documented specifications; purchasing or paying for goods or services in advance of need or before the due date, with resulting extra costs to the taxpayer for storage, obsolescence, spoilage, loss of warranty or foregone interest.

Exhibit 5.2

1984-85 YEAR-END SPENDING

	Billions $
Transfer Payments to Provinces and Territories	2.8
Public Debt Charges	2.7
Social Payments (e.g., Family Allowance, Old Age Security)	2.3
Payments to Crown Corporations / Government Contribution to UIC Fund	1.9
Salaries and Wages	1.6
Oil Import Compensation and Petroleum Incentive Payments	1.3
Provision for Valuation	.8
Total Year-end Non-discretionary Spending	**13.4**
Construction and Acquisition of Machinery and Equipment	1.5
Grants and Contributions	1.1
Professional and Special Services	.7
Utilities, Materiel and Supplies	.6
Other	1.1
Total Year-end Discretionary Spending	**5.0**
Total Year-end Spending	**18.4**

5.15 Part of our work was to note instances, where we found them, of non-compliance with relevant directives, controls and legislation. Examples included cases where year-end cut-off was disregarded and where goods or services received in the new year were paid for out of old-year funds.

5.16 We used the following audit criteria for the study:

In spending discretionary funds, there should be

- a defined need for goods or services related to approved program objectives;
- consideration for the cost of money;
- consideration for the most economical option available; and
- compliance with relevant authorities, including directives, legislation and controls.

5.17 We selected 1,309 transactions from the year-end expenditures of 45 departments and agencies. These included all transactions over $2 million and a statistical sample of the rest. The application of statistical theory allowed us to use the results of this sample to make a mathematical projection of extra cost to the taxpayer in all the transactions from which we selected our sample.

5.18 The transactions were chosen from the four categories of expenditure that we considered the most discretionary and that had the most dollars available for discretionary spending – Professional and Special Services, such as legal and engineering services; Utilities, Materiel and Supplies; Construction and Acquisition of Machinery and Equipment; and, with certain exclusions, Grants and Contributions such as subsidies, capital assistance, and payments to universities and to encourage employment. Under Grants and Contributions we excluded payments to individuals such as family allowances and transfer payments to the provinces, because there is little or no discretion involved in either the amount or timing of these payments.

5.19 We also reviewed each audit entity to determine whether there were other areas of potential extra cost to the taxpayer at year end that should be audited in addition to the 1,309 transactions described earlier. As well, we visited 30 receiving, warehousing and office locations of departments and agencies at 31 March 1985.

5.20 Where departments and agencies had made payments in advance of need or before the due date, we calculated the "time value" or "cost of money". All interest or other calculations have been done either to the date equipment was first put into use, or when payment was due, or to the date of our latest updated information, whichever was earlier. We calculated interest costs at the average three-month Treasury Bill rate which was 9.5 per cent for 1985-86.

Observations

5.21 The sample we examined indicated that expenditures at the 1984-85 year end were generally made on items that were within documented specifications and for which there was a defined need. In most cases, spending for these items was planned well in advance. Of the 1,309 transactions we audited, we found, however, that 28 expenditures from 11 departments and agencies were made in advance of need or before the due date. These resulted in interest and storage costs that constituted extra cost to the taxpayer. Using the results of our statistical sample, we estimated that the extra cost associated with year-end spending in the four categories of expenditure we examined was approximately $3 million.

5.22 The additional audit work referred to earlier, such as observing goods being received or stored in warehouses, resulted in our finding six instances of expenditures made in advance of need or before the due date. Although these cases are not included in the $3 million estimate of extra cost to the taxpayer, they support the results of the sample. The total amount of extra cost for these six items was $40,000.

5.23 The findings in this chapter are consistent with our observations when we examined, based on a smaller sample, 1982-83 year-end expenditures (1984 Report, Chapter 1), and with the findings of the Office of the Comptroller General when it reviewed 1981-82 year-end expenditures.

Examples of Extra Costs at Year End

5.24 The following are included only to illustrate typical examples of our findings and should not be taken out of context. Another example of extra costs at year end is given in Chapter 3 in an audit note concerning the Department of Regional Industrial Expansion. This is not part of our sample.

5.25 **Special Recovery Capital Projects Program (SRCPP) - National Research Council of Canada and Department of Agriculture.** This program was instituted in 1983 as a four-year program to spur economic recovery and restore the economy's capacity to generate new jobs. The program had two milestones that departments had to comply with: project start-up within six months of April 1983, and expenditure of 60 per cent of project funds by 31 March 1985. If 60 per cent of the funds were not spent by 31 March 1985, the Department would have lost the funding; therefore, this created a special type of lapsing concern for managers. In November 1984, the Government announced cancellation of the program as of 31 March 1985. All SRCPP projects and funds are now included in the budgets of the departments involved.

5.26 We have not attempted an evaluation of the SRCPP. However, we have identified extra costs to the taxpayer associated with the program. We have included the extra costs identified,in our sample as part of our estimate because they were payments in advance of need which occurred at the year end due to the requirement of the program. Our estimate of $1.5 million for SRCPP mentioned earlier does not include costs associated with additional transactions audited at the National Research Council of Canada (NRC) and Department of Agriculture in addition to the sample transactions. Costs associated with the NRC and Agriculture purchases described below total $3.6 million.

5.27 To 31 March 1985, the NRC had purchased $11.5 million of equipment and furniture for the Biotechnology Research Institute in Montreal. Approximately 65 per cent, or $7.5 million, of the equipment and furniture is in storage and will remain there at least until October 1986, the expected completion date of the building. Purchasing and storing of this equipment began in March 1984 and, to 30 June 1986, resulted in storage and foregone interest costs of approximately $2.7 million on the warehoused equipment. As well, warranties may expire or be reduced before some equipment is used, possibly causing additional costs to be incurred. Extra costs will be incurred to pay for transportation to move equipment to the new institute when it is completed. Management recognizes that this equipment was purchased in advance of need to meet the requirements of the program. We were informed that efforts were made to ensure the equipment will be useful and up to date at the time it is finally put into use.

5.28 To 31 March 1985, the Department of Agriculture purchased $8.2 million of equipment for the Ste-Hyacinthe Research Centre. Purchasing and storing of this equipment began in the summer of 1984 and resulted in storage and foregone interest costs of approximately $900,000 to 30 June 1986. Extra costs were incurred to pay for transportation to move the equipment to the research centre in the spring of 1986.

5.29 **Department of National Defence**. The Department paid for $2.4 million worth of fuel oil in March 1985. The Department usually replenishes its oil supply as needed. In this case, however, the oil was stored in a tank leased from the supplier for the nominal sum of one dollar for the period from March to December 1985. Under a separate agreement, this fuel oil was immediately made available back to the supplier to be used by its other customers, indicating that all the fuel was not required prior to 31 March. However, the supplier agreed to replenish the oil by delivering it to the Department's ships in April, May and June 1985.

Interest cost on this payment in advance of need was $14,400.

5.30 **Department of Transport.** The Department contracted for the purchase of an $87,000 tractor with automatic transmission on 6 March 1985. Departmental plans indicated it should be purchased in 1985-86 as a replacement for a tractor in service. The new tractor arrived at the Calgary dealer's shop in late March, but the automatic transmission was missing. The Department took delivery of the tractor without the automatic transmission, paid $70,000 for it, and charged it to 1984-85; however, it did not take physical delivery of the vehicle until September 1985.

Interest cost on this payment before receipt of goods was $2,400.

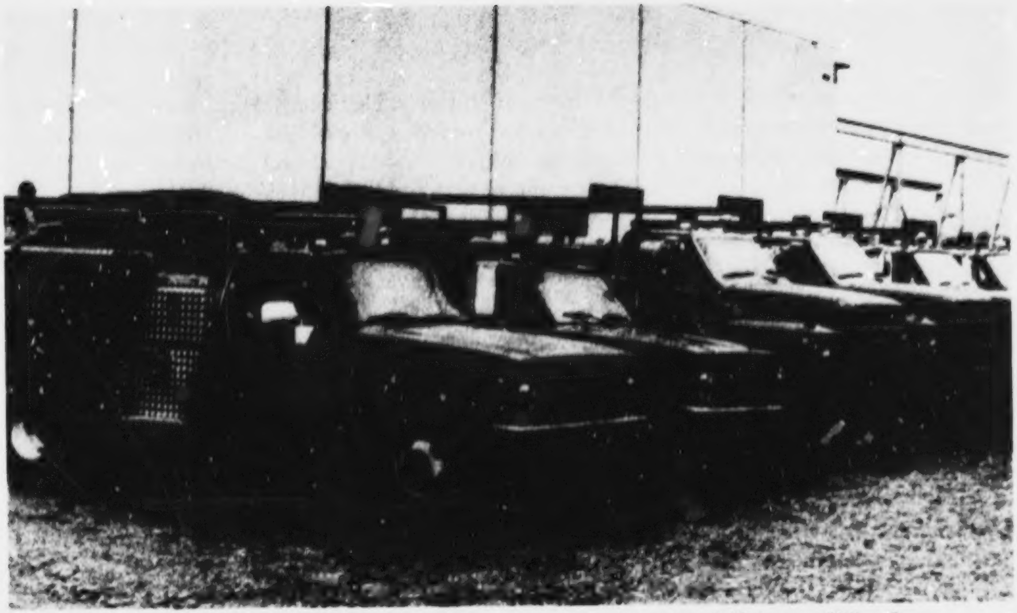
5.31 **Canadian International Development Agency.** The Agency had planned to make a contribution of $700,000 on 1 April 1985 for a multi-year project that was approved in January 1984. On 26 February 1985 the Agency made a modification to the schedule of payments to disburse $400,000 for the project in fiscal year 1984-85. The recipient had unused advances of more than $200,000 on hand at 1 April 1985. Additional funds were not required until the third quarter of 1985.

Interest cost on this payment in advance of need was $21,900.

5.32 **Canada Employment and Immigration Commission.** We found two cases of final payments on contributions paid before due date in CEIC. Under the terms and conditions of the agreements governing Skills Growth Fund Projects, the final 15 per cent of the contribution to the project may only be paid when the project is complete and operational. Final payments of $557,400 and $600,000 were paid in April 1985 and charged to the 1984-85 fiscal year, even though the projects were not complete and operational in 1984-85.

Interest cost on these payments before due date was $58,600.

5.33 **Department of Indian Affairs and Northern Development**. The Department established a need for fire engines for Indian bands in the late 1970s and early 1980s. A decision was taken in January 1985 to purchase six of them for $452,000. The Department took delivery of the fire engines at the supplier's plant on 29 March 1985 and the vehicles were tested in April 1985. Four of the fire engines were paid for from 1984-85 funds; two were paid for from 1985-86 funds.



These fire engines were purchased by the Department of Indian Affairs and Northern Development in March 1985, but distribution to Indian bands took place from May 1985 to July 1986 (see paragraph 5.33).

Some bands were unable to accept immediate delivery because they had to pass a resolution to accept the fire engine, build a fire-house, and train volunteer fire fighters. They were delivered to the bands on 15 May, 14 June, 19 July, 29 July and 21 October 1985 as bands became ready to receive them. One engine that was stored at Prince George, B.C., was not delivered until July 1986, because the band designated to receive it did not have enough money to build a fire-house. Storage and insurance costs were paid by the Department.

Interest, storage and insurance costs on these payments in advance of need were $13,400.

5.34 **Department of Fisheries and Oceans.** The Department had a contract for construction of a hydrographic survey vessel. The contract called for progress payments to be made at certain milestones. A $510,000 partial payment for one of these milestones was made on 29 March 1985, although the milestone was only completed and billed on 13 June 1985 and payment was due on that date.

Interest cost on this payment before due date was $10,300.

Other Observations

5.35 We also found three methods used by departments and agencies to avoid lapsing funds. One is the use of the accounting records to record transactions in one fiscal year that should have been recorded in the following fiscal year. Most of these errors did not involve any extra cost to the taxpayer; however, the year of recording the transactions was incorrect. These errors are not in accordance with government directives on accounting procedures at year end.

5.36 For example, in the Department of National Defence, we found nine instances, totalling $105 million, where transactions were recorded in 1984-85 that should have been recorded in 1985-86. These were mainly for contract advances recorded in the wrong year and for goods received in the 1985-86 year and charged to the 1984-85 year. In one case the Department recorded a $27 million holdback in 1984-85. It is the usual practice to record a portion of a contract as a holdback as the work progresses. In this case no work had been performed under the contract and the holdback should not have been recorded.

5.37 A second technique used by departments to avoid lapsing funds is to amend contracts at year end to change the point at which they accept goods. Instead of accepting goods at the normal destination to which the supplier would have shipped them, departments sometimes accept goods at the supplier's plant. This enables the department to accept delivery earlier and results in equipment purchases being recorded in 1984-85 rather than 1985-86. We found eight cases, totalling $2.1 million, where this occurred in the Department of National Defence. This practice exposes departments to increased risks with no offsetting benefits other than to ensure that funds do not lapse. Some of the risks involved with changing acceptance points are that the goods are still physically located with the supplier, but, because the government has accepted delivery and is a self-insurer, it would have to bear the full replacement costs if goods were destroyed, any liability costs that may have resulted from an accident, and any extra costs that may have resulted from the expiry of warranties.

5.38 Third, a department or agency may avoid lapsing funds by making payments to organizations that would normally be made in a future year. This problem is magnified when Supplementary Estimates, approved late in the year, give an organization a limited time frame to approve and make payments. Examples of this problem are payments made to universities by the Natural Science and Engineering Research Council at the end of 1984-85. The Council, having received increased funding as a result of Supplementary Estimates, paid general research grants of $ 9.5 million to Canadian universities for the 1985-86 fiscal year out of 1984-85 funds. In this case the agency followed government directives on paying grants. However, there was a $400,000 cost of money involved with paying in advance of need.

CANADA EMPLOYMENT AND IMMIGRATION COMMISSION

CANADA EMPLOYMENT AND IMMIGRATION COMMISSION

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6

CANADA EMPLOYMENT AND IMMIGRATION COMMISSION

Overview

6.1 The law governing employment and immigration was amended in 1977, bringing together the Department of Manpower and Immigration and the Unemployment Insurance Commission to form the Canada Employment and Immigration Commission (CEIC) and the Department of Employment and Immigration.

6.2 CEIC is responsible for employment, unemployment insurance and immigration programs, while the Department is responsible for the effective development and implementation of federal policies and programs relating to the labour market and to immigration, and for informing the public about them.

6.3 The administrative headquarters of the Commission and the Department is in Hull, Quebec. The Commission's operations are decentralized, with 10 regional offices and more than 800 permanent, temporary and mobile service bureaux. The Commission uses approximately 24,000 person-years annually.

6.4 The Department comprises two divisions, which are located at headquarters: Strategic Policy and Planning; and Public Affairs. Although most of the activities of Employment and Immigration are carried out by the Commission, the Department was set up so that there would be a minister with responsibility for the portfolio and so that the usual links with central agencies would be maintained.

6.5 In addition to a president and vice-president, Commission membership includes two commissioners, one appointed in consultation with labour organizations, the other in consultation with employers' groups. The structure allows labour and management representation in the development, approval and implementation of programs affecting them. Commission headquarters is made up of seven groups, four of which are responsible for programs providing services to the public: Employment, Insurance, Labour Market Development, and Immigration. The other three units are Personnel, Finance and Administration, and Systems and Procedures, which provide professional, technical and administrative services.

6.6 The Commission administers three programs: Employment and Insurance, Immigration, and Corporate and Special Services. The objective of the Employment and Insurance program is to foster achievement of Canada's economic and social goals by ensuring that human resources are made fully productive. The Immigration program regulates the entry of immigrants and visitors to Canada in light of Canada's economic, social and cultural interests. The objective of the Corporate and Special Services program is to provide support services to the Department and the Commission and to administer government annuities, contracts and the issuing of social insurance numbers.

6.7 Parliamentary appropriations for the Department and the Commission come from the government's Social Affairs envelope. In 1985-86 CEIC received appropriations of over $6 billion. These funds administered and disbursed by the Department and the Commission in fiscal 1985-86 are set out in Exhibit 6.1.

Audit Scope

6.8 Our audit covered direct job creation and training. Within these two activities we chose the following sub-activities, for which the total cost was more than $1 billion:

- Employment Creation Grants and Contributions;
- Local Employment Assistance and Development; and
- National Institutional Training.

6.9 In 1985, the Commission announced the introduction of the Canadian Jobs Strategy, comprising six programs. At the time of our audit, these activities were still at the implementation stage. We therefore postponed the audit of the new programs until 1986-87.

6.10 For the sub-activities selected for our audit, we examined planning, program development, implementation, monitoring and control, and evaluation. We also looked at the systems used to transmit information to Parliament and management. We wanted to determine whether these activities were being carried out economically and efficiently and whether systems were in place to measure and report on effectiveness.

Employment Creation Grants and Contributions Program

Background

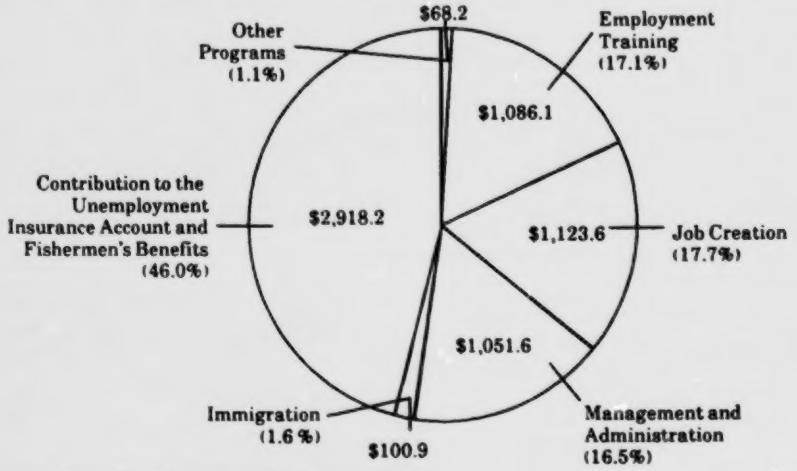
6.11 The Employment Creation Grants and Contributions program (ECGC) is a special program of direct job creation, set up in the spring of 1982, to permit rapid implementation of projects proposed under the Special Employment Initiative (SEI) announced by the Minister of Finance in the budget of 28 June 1982. SEI was one of several measures announced to reduce unemployment and provide support for areas that had been seriously affected by the economic recession and by high interest rates. Parliament was told that the objective of SEI was to fund labour-intensive projects within the existing government programs.

6.12 In addition to being used to realize projects under this initiative, the ECGC program also served for projects under the LaPrade Fund. The government established this fund in 1982 for financing activities undertaken to counter the effect of closing the heavy water plant in LaPrade, Quebec.

6.13 Between 1982 and February 1986, CEIC funded 2,146 projects through the ECGC program at a total approved cost of $204.7 million. Under the program terms and

Exhibit 6.1

EMPLOYMENT AND IMMIGRATION CANADA
FINANCIAL RESOURCES AND EXPENDITURES
1 APRIL 1985 TO 31 MARCH 1986
(millions of dollars)



Source: Main and Supplementary Estimates, 1985-86.

Note: Includes administrative costs charged to the Unemployment Insurance Account ($903.9 million) but does not include claims paid from the Account, except those paid under sections 37, 38 and 39 of the Unemployment Insurance Act ($370 million).

conditions, projects could be funded by either grants or contributions. By the end of February 1986, 96 per cent of the amount disbursed to projects under the program was in the form of grants.

6.14 The ECGC program will continue in effect in 1986-87 to allow completion of some 20 projects.

6.15 Of the total amount approved for the program, 92 per cent went to construction projects where the main beneficiaries were municipalities, community organizations, non-profit groups and religious organizations. Among the projects were the construction or improvement of sewers, city halls, bridges, roads, sidewalks, parks, industrial parks, sports and recreation centres and churches. The balance of the funds went to tourism development and establishing community centres, youth employment centres, counselling services and assistance centres for the unemployed.

6.16 Exhibit 6.3, shown later, presents the approval process for ECGC projects. The government had designated certain regional ministers to look after the interest of various regions. Contrary to normal CEIC practice in job creation programs, these regional ministers submitted projects to the Commission for review and later played an important part in their approval.

6.17 The purpose of our audit was to assess the process and the management controls in place for administering the ECGC program to determine whether it had been managed with due regard for economy and effectiveness.

6.18 The audit included the examination of a sample of project files in five regions: New Brunswick, Quebec, Ontario, Manitoba and British Columbia. Projects in these regions accounted for 91 per cent of the total amount approved for ECGC projects.

6.19 We chose 61 files from the selected regions. We ensured that the sample was representative of the overall population of ECGC projects. Total grants and contributions made to the projects examined amounted to $32 million.

6.20 We examined the files to assess the procedures used by CEIC before and after project approval. We visited eight of the projects in the sample and met the project sponsors.

6.21 **Objectives of the program.** The specific objectives of the ECGC program were not clearly defined. Parliament approved the overall objective of the ECGC program in Vote 15 of the Main Estimates, which states that the amount spent by the program was for the purposes of "providing employment to unemployed workers and contributing to the betterment of the community". Moreover, other CEIC documents and the agreements with recipients confirm that the objective was to create jobs for the unemployed.

6.22 In developing and implementing the ECGC program, however, CEIC did not translate this broad objective into specific and measurable goals, and failed to establish clear operational definitions. Although the Commission does set specific goals such as the number of jobs or work-weeks to be created for its other direct job creation programs (Canada Works, Local Employment Assistance and Development, Job Corps and Career Access), it set no such goal for ECGC. Nor did the Commission establish a target with respect to the cost of creating these jobs.

6.23 **Measurement of results.** The audit showed that CEIC did not establish a mechanism to assess whether intended objectives had been achieved or to measure program results. Further, the Commission did not collect data on the number and cost of jobs actually created for unemployed workers by the projects that were approved.

6.24 After spending approximately $200 million on the ECGC program, CEIC did not know how many jobs or work-weeks it had actually created or what their average cost had been.

6.25 **CEIC should set clear objectives in operational and measurable terms for all its programs and should establish mechanisms to evaluate the results achieved.**

> *Commission's response: It is the normal practice for CEIC to set clear objectives in operational and measurable terms. These objectives were not set in respect of*

Employment Creation Grants and Contributions because the intention of the government was not to utilize the funds in the same way as with the normal programs, a fact which the Report highlights. The Commission made its position quite clear in its submission to the Treasury Board dated 14 September 1982. It requested and received (Minute No. 784672) authority to provide the funds in the form of grants, as it believed that it could not meet the detailed twin objectives of carrying out the type of projects being submitted and ensuring the control that payment by contributions required. It is important to recognize the mechanism was put into place and operational at a time, in 1982, when Canada was deep in a recession. Extraordinary measures, like Employment Creation Grants and Contributions, were called for to deal with the various kinds of labour market dislocations which were occurring at that time.

Program Design

6.26 **Program development.** To reduce the approval time for projects proposed by regional ministers, the government adopted a "fast-track" process for selecting, assessing and approving the projects they deemed worthwhile. Thus the program, heavily influenced by elected representatives, was designed and developed within a short time. Contrary to normal practice in setting up a job creation program, we found no planning or other discussion documents setting out the needs to be fulfilled by the program, its objectives, the options for meeting those objectives, or the financial and operational implications of each option.

6.27 In the following sections, we explain how the program terms and conditions and the assessment and monitoring procedures were designed to provide flexibility in project selection and speed in distributing funds. Little attention was paid to project results in terms of job creation for the unemployed and cost per job created.

6.28 **Terms and conditions.** Although projects had to meet certain criteria to be eligible for grants, the criteria, in our view, were not such as to ensure that a project would create jobs economically and effectively. The three main criteria proposed by the Commission and approved by Treasury Board had the effect that virtually all proposed projects qualified for grants. Once a regional minister had approved a project, it had to meet only one of the following criteria:

- the project was receiving substantial sums ($10,000 or 10 per cent of the total cost, whichever was higher) from a source other than the federal government;
- the duration of the project was 26 weeks or more; or
- the amount requested did not exceed $250,000.

6.29 The third criterion was the one used most often. Ninety-four per cent of proposed ECGC projects asked for less than $250,000.

6.30 The eligibility criteria for contributions were more stringent in terms of using the funds to create jobs. Project sponsors had to submit employment plans showing that at least 50 per cent of those employed on the project would come from the ranks of the unemployed.

6.31 The definition of the term 'job' was so flexible, however, that a project might offer little work to the unemployed yet still be eligible for support. The following is an excerpt from the Program Implementation Procedures:

> To provide the maximum flexibility, it has been agreed that the 50 per cent rule will apply only to the total number employed over the life of the project. It is not essential that at least 50 per cent of those employed must have come from "the unemployed" at all times, or even each month. In addition, it is agreed that the count will be made solely on the number employed without reference to any period of time that a person may have worked. To give an extreme example, a project that hired two unemployed persons for one day and one person for the life of the project would satisfy the requirement as 2 out of the 3 persons employed over the life of the project would have come from "the unemployed".

6.32 **Use of grants.** The use of grants as the funding mechanism for construction projects was contrary to recommendations of the Public Accounts Committee and to usual government practices. For the first three months of the program, the terms and conditions allowed funding only through contributions. Most of the projects involved construction projects that were to be carried out by contractors and sub-contractors.

6.33 According to some CEIC officials, requiring that an employment plan be drawn up and that progress be monitored against the plan would have imposed onerous conditions on the project sponsors that would have been difficult to enforce on construction sites. It would also have been difficult to estimate the number of unemployed that might be used on construction projects lasting 26 weeks or longer. But the Commission requires that similar procedures be followed in its other job creation programs where construction is involved.

6.34 In 1977, the Public Accounts Committee recommended that "financial assistance of a capital nature be classified as contributions (not grants) and administered as such, including the requirements for the submission of financial statements and reports on the use of funds".

6.35 Following that recommendation, Treasury Board altered its policy on the use of grants and contributions. In Chapter 9.4 of the Guide on Financial Administration for Departments and Agencies of the Government of Canada, the policy stipulates that "All assistance to projects of a capital nature must be classed as contributions, unless otherwise directed by Treasury Board".

6.36 On 20 September 1982, Treasury Board approved the principle proposed by CEIC that ECGC projects be funded through grants. As a result of this decision, 96 per cent ($196.5 million) of the amount approved for ECGC projects was disbursed in the form of grants, and only 4 per cent ($8.2 million) in the form of contributions.

6.37 In the ECGC program, the Treasury Board has not followed its normal practices. For other job creation programs involving construction projects, the Treasury Board normally requires that they be funded by contributions.

6.38 In our view, given the nature, size and duration of the projects, the use of grants was inappropriate. Paragraphs 6.214 through 6.224 deal with this subject and contain our recommendations about it.

6.39 **Operational guidelines.** The program terms and conditions gave CEIC officials responsibility for assessing project funding requests submitted by regional ministers to assure compliance with the stated criteria. The procedures established by CEIC for this assessment and for administering project files were set out in operational guidelines. However, these guidelines offered little operational guidance in the way of interpreting the eligibility criteria, reviewing projects, monitoring and following up actual results. They did not call for – nor did they prohibit – the monitoring and follow-up procedures that were normally used in job creation programs. As a result, we found that each region interpreted the guidelines in its own way.

6.40 The operational guidelines encouraged officials to accept proposed projects and recommend them for approval by the Minister of Employment and Immigration. They stated, for example, that "inasmuch as the Government wishes to proceed with these projects, recommendations to the contrary must be well founded", and "the Government had indicated its intention to fund all of the projects put forward if possible...".

6.41 The result was that funding requests were assessed superficially, with little regard for the number and costs of jobs and work-weeks forecast.

6.42 The operational guidelines did not encourage officials to monitor achievement of the objectives Parliament had been told would apply to projects receiving grants. For example, they stated that "Treasury Board does not require monitoring of projects funded by grants".

6.43 Regional offices, therefore, were not obliged to require reports from sponsors on the actual number of jobs or work-weeks created for the unemployed and others, or to measure actual results. Regional offices did, however, monitor other aspects of the projects, such as progress on construction.

6.44 The operational guidelines for the program gave little guidance to the officials responsible for assessing ECGC projects on how to interpret the eligibility criteria or evaluate the projects in terms of their economy and effectiveness in creating jobs. None of the criteria governing eligibility for grants was defined clearly in the guidelines. The guidelines did not specify how to assess whether employment levels set out in project budgets were acceptable and did not set out procedures for determining whether qualified unemployed people were available for proposed projects. In this way, in the summer of 1985, one project received $500,000 even though unemployed workers were not available in the area.

6.45 **For each of its programs, CEIC should issue clear operational guidelines that facilitate the achievement of objectives and the measurement of results.**

> *Commission's response: It is the normal practice of CEIC to issue operation guidelines that facilitate the achievement of objectives and the measurement of results. These were not issued to the same degree as normal in the case of Employment Creation Grants and Contributions, because of the unusual nature of the program and the difficulties envisaged at the commencement of the program and set out in the submission to Treasury Board dated 14 September 1982. As the Report indicates, the instructions to CEIC from the government were quite clear. It wished to have funded the projects identified by Regional Ministers.*
>
> *Employment Creation Grants and Contributions (or the Immediate Employment Stimulation Component, as it was initially called) was not set up as a program in its own right. It was set up to provide a mechanism for those projects which the government wished to implement under the Special Employment Initiative fund that could not be carried out under a then-existing authority or program of any federal department. Therefore, CEIC was unable, for example, to allocate funds to regions on a formula based on unemployment, as would be the normal practice of the Commission. The allocations to regions were determined by the government at the higher level of the Special Employment Initiative fund. The amount of Employment Creation Grants and Contributions funds provided to each region was merely a reflection of the type of project submitted by Regional Ministers.*
>
> *Similarly, with the normal programs, projects are usually totally funded by the Commission and start within a short period after approval. Many of the projects submitted under Employment Creation Grants and Contributions involved the payment of funds from other levels of government, which the federal government was anxious to trigger in order to help combat the severe unemployment conditions of the early 1980s. The program was meant to be a fast non-bureaucratic response to these exceptional conditions, and it was to be delivered with minimal resources. Few human resources were, accordingly, provided for implementation.*
>
> *The operating guidelines to regional offices stated: "On occasion, it may be necessary for the federal government to be seen to be accepting their part of the commitment before others will participate". In Quebec, in particular, the then-prevailing political situation precluded the early commencement of some projects, some of which, as the Report points out, did not start for several years. These long time delays created situations where funding decisions on the method of payment made at the time of approval were rendered invalid by later developments, but could not then reasonably be changed.*

6.46 **Distribution of funds.** Given that ECGC is a job creation program for the unemployed, it would be reasonable to assume that program funds would be distributed among the various regions of the country according to each region's share of overall unemployment.

6.47 CEIC was not able to provide information about the criteria used to distribute funds among regions because it was not involved in this process. Cabinet had allocated

Special Employment Initiative (SEI) funds to regional ministers. We did not pursue the basis of this allocation.

6.48 We compared the portion of ECGC funds received by each province in fiscal years 1982-83 through 1984-85 with their share of national unemployment (Exhibit 6.2). The analysis showed some significant discrepancies. Although Quebec, on average, had less than one-third of the country's unemployed between 1982-83 and 1984-85, the province received about half the funds allotted to ECGC. By contrast, Alberta had about nine per cent of the country's unemployed but received almost nothing under the program. There was also a significant gap in the case of British Columbia.

Program Delivery

6.49 **Solicitation of projects.** In its other direct job creation programs, CEIC is responsible for soliciting funding requests and selecting the projects to be funded. Contrary to established practice, this responsibility was given to regional ministers for the ECGC program. As well, another atypical practice was that ministers and other Members of the House of Commons played a major role in this process (Exhibit 6.3).

6.50 At the beginning, the ECGC program, its eligibility criteria and ways to gain access to the program were not public knowledge. To judge from statements in the House of Commons at the end of 1983 and the beginning of 1984, opposition Members were no more aware of the program than the general public. This, in addition to questions asked in the Standing Committee on Labour, Manpower and Immigration, showed that there was confusion about the objectives for SEI funds and the ECGC program, eligibility criteria and application procedures for obtaining project funding.

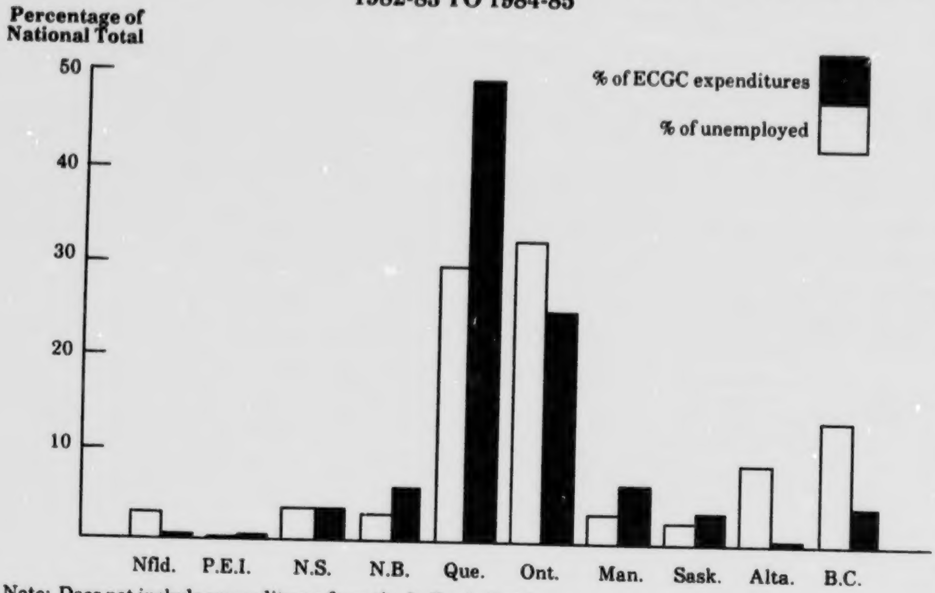
6.51 It was not until 1 February 1984, following these questions – and 20 months after the program was introduced – that the House received some information about objectives and eligibility criteria. The information did not explain clearly the criteria used to assess projects or the procedure for applying for funds.

6.52 Our audit showed that project proposals originated with regional ministers and Members of Parliament. We could not discover what criteria regional ministers used to select the projects that they submitted to CEIC; these criteria were never communicated to all Members of Parliament and to the public.

6.53 **Review and approval of funding requests.** In our view, once regional ministers submitted projects, CEIC headquarters did not require regional offices to look closely enough at projects to ensure that they would achieve the program's stated goals in an economical manner. In the following sections, we show the effects of these weaknesses on the process for reviewing and approving funding requests.

Exhibit 6.2

CEIC - EMPLOYMENT CREATION GRANTS AND CONTRIBUTIONS DISTRIBUTION OF EXPENDITURES AND UNEMPLOYED BY PROVINCE 1982-83 TO 1984-85



Note: Does not include expenditures from the LaPrade Fund.

6.54 Projects were approved without sufficient attention to their likely effects on job creation for the unemployed. In 51 of the 61 project files we examined during the audit, there were no forecast data on the number of work-weeks for the unemployed or the cost per work-week (that is, the amount of the grant or contribution per work-week). When a sponsor indicated how many work-weeks a project would give the unemployed, project officers did not analyse this figure and the cost per work-week to see whether they were reasonable.

6.55 In 13 of the 61 files examined, there was no information on the total number of work-weeks to be created, whether for the unemployed or for others. In the other 48 projects, we found information in the file about the total projected number of work-weeks to be created. For these projects, we were able to calculate the projected cost per work-week. In almost half the projects (23 out of 48), the estimated cost per work-week was more than $1,000. In 9 out of 48 projects, the cost was more than $2,000 per work-week. The data did not allow us to estimate the cost of jobs for the unemployed. We were also unable to determine the actual cost of job creation for these projects.

6.56 Because the job creation effects of projects were not considered or analysed, projects with relatively small labour components were approved. As a result, the cost per work-week created was high (see Exhibit 6.4).

Exhibit 6.3

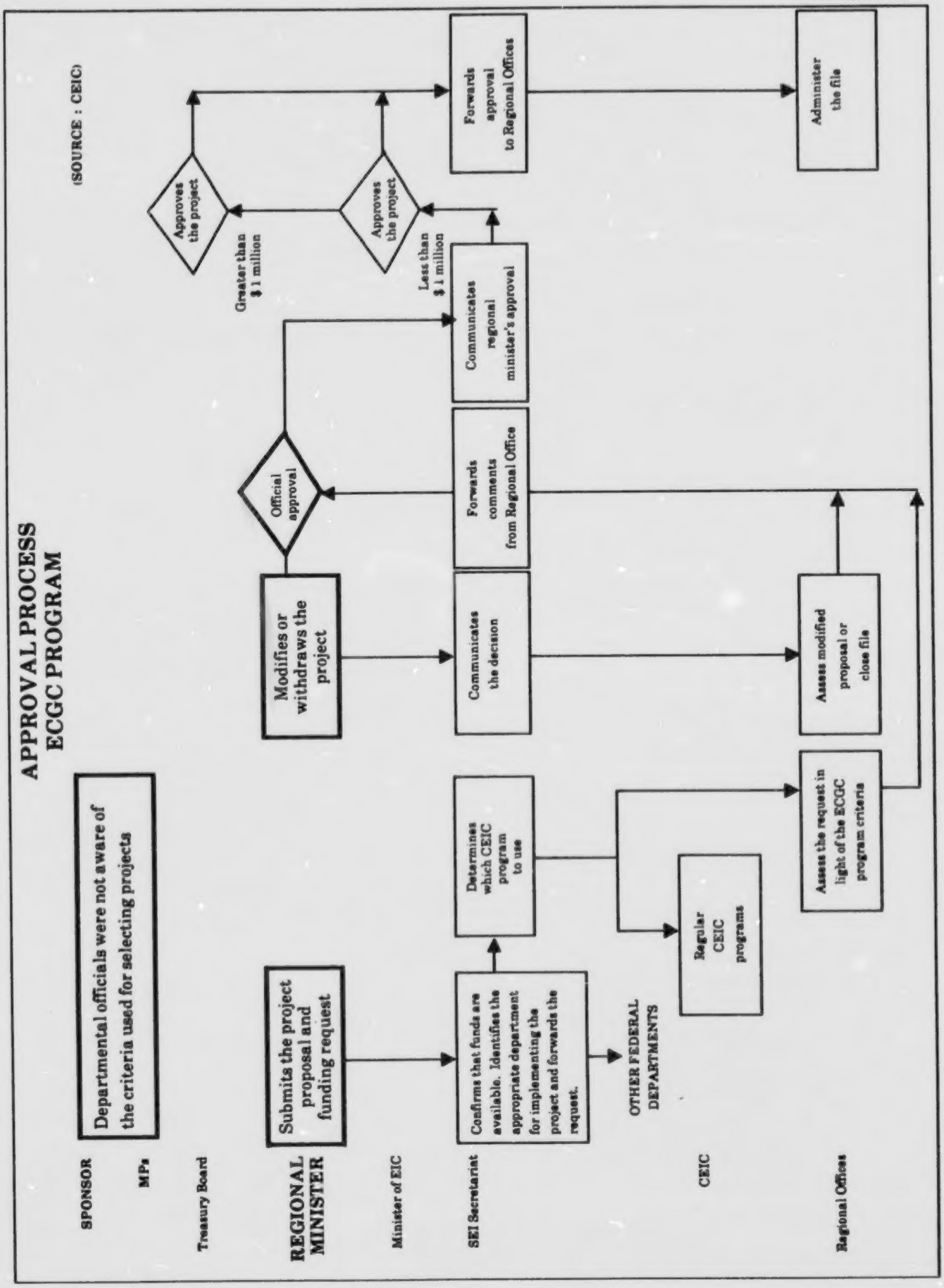
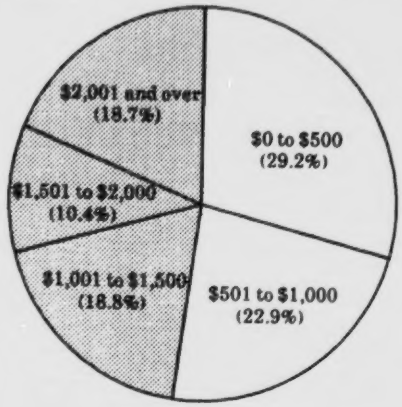

APPROVAL PROCESS
ECGC PROGRAM
(SOURCE : CEIC)
SPONSOR
MPs
Treasury Board
REGIONAL MINISTER
Minister of EIC
SEI Secretariat
CEIC
Regional Offices
Departmental officials were not aware of the criteria used for selecting projects
Submits the project proposal and funding request
Confirms that funds are available. Identifies the appropriate department for implementing the project and forwards the request.
OTHER FEDERAL DEPARTMENTS
Determines which CEIC program to use
Regular CEIC programs
Assess the request in light of the ECGC program criteria
Modifies or withdraws the project
Communicates the decision
Assess modified proposal or close file
Official approval
Forwards comments from Regional Office
Communicates regional minister's approval
Less than $ 1 million
Greater than $ 1 million
Approves the project
Approves the project
Forwards approval to Regional Offices
Administer the file

Exhibit 6.4

CEIC - EMPLOYMENT CREATION GRANTS AND CONTRIBUTIONS

Forecast Average Cost per Work-Week
Distribution of Audited Projects



In almost half the audited projects, the forecast cost per work-week was more than $1,000.

6.57 These costs are much higher than the cost per work-week created through other direct job creation programs administered by CEIC. For example, the cost per work-week created in fiscal 1985-86 by the Canada Works program – the program most similar to ECGC in terms of its objectives and target clientele – was $311. Following are examples:

- A municipality obtained a grant of $250,000 to expand an arena. The project was to create 82 work-weeks, 45 of them for the unemployed, at a cost of $5,556 per work-week created for the unemployed, and $3,049 per week for the unemployed and others taken together.
- CEIC gave a grant of $75,000 to a non-profit organization to build a softball field. The project was to create 15 work-weeks, at a projected cost of $5,000 per week. We found no information on the number of work-weeks to be created for the unemployed.
- A non-profit group received a grant of $835,000 to renovate a building. The file indicated that 225 work-weeks were to be created, at a cost of $3,711 per work-week.

6.58 Projects were approved when it was clear from the nature of the activities described that few or no unemployed people could work on them. The terms and conditions of the program stated that "(project) proposals must demonstrate that they are in respect of an activity on which those employed on the project will be drawn substantially from the ranks of unemployed persons".

6.59 For example, CEIC paid a university students' association a contribution of $375,000 and a grant of $1 million to fund a project to create part-time jobs for students during the school year. After examining the application, the regional program director advised CEIC headquarters that the project did not meet the eligibility criteria because the participants were full-time students and could not properly be called 'unemployed'.

6.60 Headquarters then advised the regional office that students should be considered "part-time unemployed", and asked for a new assessment and recommendation in light of these new instructions. The regional office recommended approval of the project.

6.61 In this way, CEIC broadened its own definition of unemployed to make the project eligible for the program. In our view, the nature of the project was such that it met neither the objective approved by Parliament nor the eligibility criteria of the program and should not therefore have been approved.

6.62 We observed during the audit that the awarding of some grants was announced publicly or confirmed by Members of Parliament to sponsors before CEIC officials had completed their review of project proposals. The government therefore had only a summary description of the projects, and no analysis of forecast costs had been done. CEIC officials thus found themselves in the delicate position of having to assess projects and make recommendations for approval, knowing that their Minister had already agreed to fund the projects.

6.63 For example, three Members of Parliament announced, on behalf of the Minister of Employment and Immigration, the awarding of a grant of $1.5 million to a non-profit group to build a network of bicycle paths and some boat launching ramps. On another occasion, the Minister of Employment and Immigration confirmed to a Member of Parliament that a parish council would receive a grant of $500,000 to build a community centre. In both cases, officials had not completed their assessment of the applications and had made no recommendations.

6.64 **Other observations.** We also noted that 6 of the 61 projects examined were approved, even though they failed to meet the eligibility criteria for grants. Headquarters did not require an assessment of the sponsor's financial ability to complete the project. This deficiency was reflected in the fact that in six projects we audited, additional funds were approved to allow the sponsors to complete the projects.

6.65 In our view, however, the financial procedures and controls established by CEIC were adequate to ensure that the amounts disbursed to project sponsors were in fact spent on approved project activities.

Accountability

6.66 In placing the funds allotted to the ECGC program in the CEIC Estimates, Parliament assigned CEIC responsibility for administering the program and, at the same time, the obligation to account for its use of the funds.

6.67 ECGC was a special program, strongly influenced by elected representatives, that sidestepped normal administrative procedures so that job creation projects could be initiated more quickly than usual.

6.68 Elected representatives certainly have the responsibility to develop policies. They are also ultimately accountable to the electorate for the implementation of these policies and the related programs. We believe, however, that in exercising this responsibility, they must not jeopardize the achievement of a program's objectives or its economical, efficient and effective operation. The role of CEIC in achieving the objectives of this program was limited to that of an intermediary. Significant decisions about the allocation and use of funds were taken by several players outside CEIC that were not obliged to account for the use of program funds.

6.69 We have shown how the program's eligibility criteria opened the door to approval of virtually any project proposed by a regional minister; how headquarters encouraged regional officials not to monitor the projects; how it directed them to accept project proposals rather than issuing clear operational guidelines on evaluating projects in relation to program objectives; and how the role of CEIC was limited to assuring communication with regional ministers, reviewing the project proposals they initiated, and administering the files for projects they approved.

6.70 According to the Commission, it served as a intermediary and had no decision-making authority about the quality of projects that were approved. The public was not informed about the program's objectives, the procedure for applying for funds, or the program's eligibility criteria. The information provided to Parliament about the funds appropriated and the results of the program did not inform Members adequately, as described later in paragraphs 6.225 through 6.231.

6.71 Regional officials did, however, perform reasonably well the program delivery role they had been assigned. In some cases, they even went beyond established procedures to monitor progress on projects. However, they were not called on to monitor projects in terms of their effects on the program's job creation objectives or the cost per job created.

6.72 Given CEIC's limited role in decisions about the use of funds allotted to the ECGC program, we could not establish the extent to which CEIC should be held accountable for the results of the program. CEIC was not particularly vigilant in reviewing project proposals and following up on the projects to ensure that public funds were being spent properly and prudently. In the following cases, each project illustrates several of the problems we have described.

Case No. 1 – An Industrial Park

In 1985, CEIC gave a grant of $773,088 to a municipality to build an industrial park to create jobs for the unemployed. A piece of land was purchased and a site-plan was prepared. But no other work has been done and no jobs have been created (see paragraphs 6.73 to 6.78).

Issues: **Ineligible project; no evaluation of project's effects in creating jobs for the unemployed; no analysis of project budget and financial status of sponsor; no analysis of the real need for the project.**

Description and Observations

6.73 On 1 December 1983, the Minister of Employment and Immigration approved a grant of $3.8 million to a non-profit corporation that was sponsoring a project to set up an industrial park. The project involved purchasing 300 acres of land and building about 16,000 feet of roads, including water mains, sewers and paving. The total cost of the project included $3.144 million for the purpose of purchasing land and materials, and $656,000 for labour costs.

6.74 The industrial park project was to create 105 jobs and provide 1,308 work-weeks, at an estimated cost of $2,905 per work-week. The file contained no information on the number of work-weeks forecast for the unemployed.

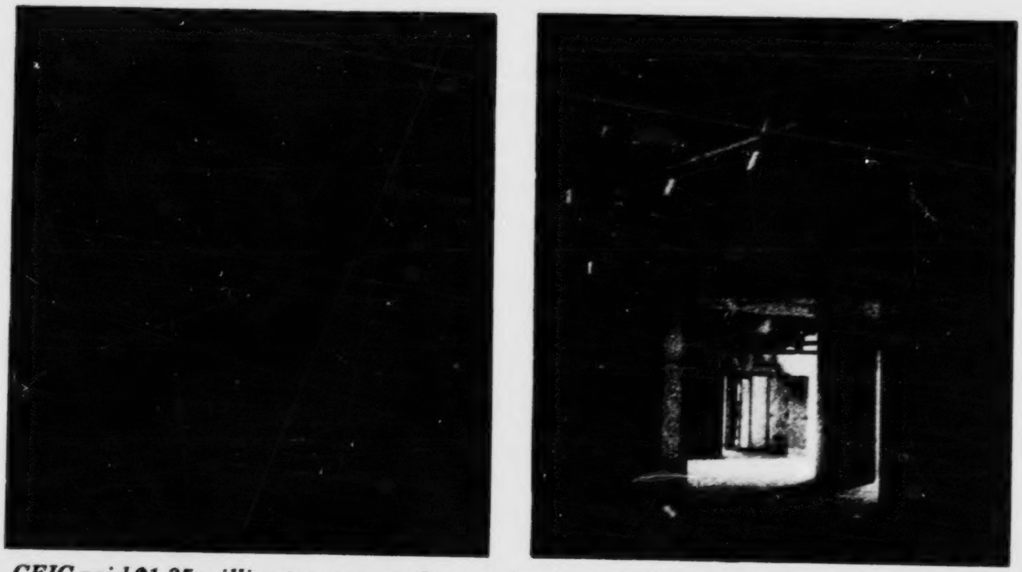
6.75 Despite serious reservations on the part of another federal department about the need for this type of infrastructure project in the region in question, CEIC recommended the project for approval without demonstrating or justifying the need for it.

6.76 After lengthy negotiations between the provincial and federal governments, it was agreed that the scope of the project would be reduced. The federal government signed an agreement on 29 March 1985. According to our analysis, at the time of signing the agreement the project met none of the three eligibility criteria necessary to qualify for a grant. As well, the sponsor provided only a superficial estimate of project costs, which CEIC accepted without further assessment.

6.77 The modified project consisted of purchasing a piece of land and preparing a site plan. It was supposed to cost $695,000, but was later raised to $773,088 to cover a cost overrun.

6.78 In April 1986, 28 months after the project was initially approved, a visit to the project sponsor revealed that no development work had been completed and the project had yet to create any work for the unemployed.

Case No. 2 – A Museum



CEIC paid $1.35 million to a non-profit organization to build a museum. Because of cost overruns and the recipient's failure to obtain other financing, the project was stopped. The Department of Public Works has now acquired the building and is looking at alternative uses (see paragraphs 6.79 to 6.85).

Issues: **Confirmation to project sponsor before officials had assessed the project; no analysis of project budget or financial capacity of project sponsor; no evaluation of project effects on job creation for the unemployed; reimbursement of expenses incurred before the agreement was signed; project not completed.**

Description and Observations

6.79 On 23 March 1983, representatives of a non-profit corporation asked the federal government for a grant to build a museum. The corporation was set up specifically for this project and was not actually incorporated until 12 May 1983. In a letter dated 21 April 1983, the Minister of Employment and Immigration confirmed with the Member of Parliament for the riding in question that a grant of $1.2 million would be awarded. The same day, the Member wrote to the sponsors confirming that the grant had been approved. The corporation therefore began to look for a site and to have preliminary plans, architectural drawings and building specifications drawn up.

6.80 So the sponsor received confirmation of the grant even before incorporation, when the government had only a preliminary description of the project, and there had been no analysis by CEIC of the construction and development costs of such an undertaking. Program officers had much difficulty in obtaining the information necessary to determine if the project was acceptable. These officers found themselves in an awkward position, because their Minister had already agreed to the project.

6.81 It was not until August 1983 that the analysis was completed. At that time, the project was to involve construction of a 12,000 square-foot building with two exhibit halls and a 150-seat auditorium. According to the information supplied by the sponsor, the project was to create 560 work-weeks, at a cost to taxpayers of $2,143 per week. The file contained no information on the number of work-weeks for the unemployed. We found no indication in the file that the sponsor's estimates had been analysed; that the feasibility of completing the project within the proposed budget had been assessed; that the potential costs of operating the museum, once completed, had been estimated; or that the sponsor was able to assume those costs that had been considered.

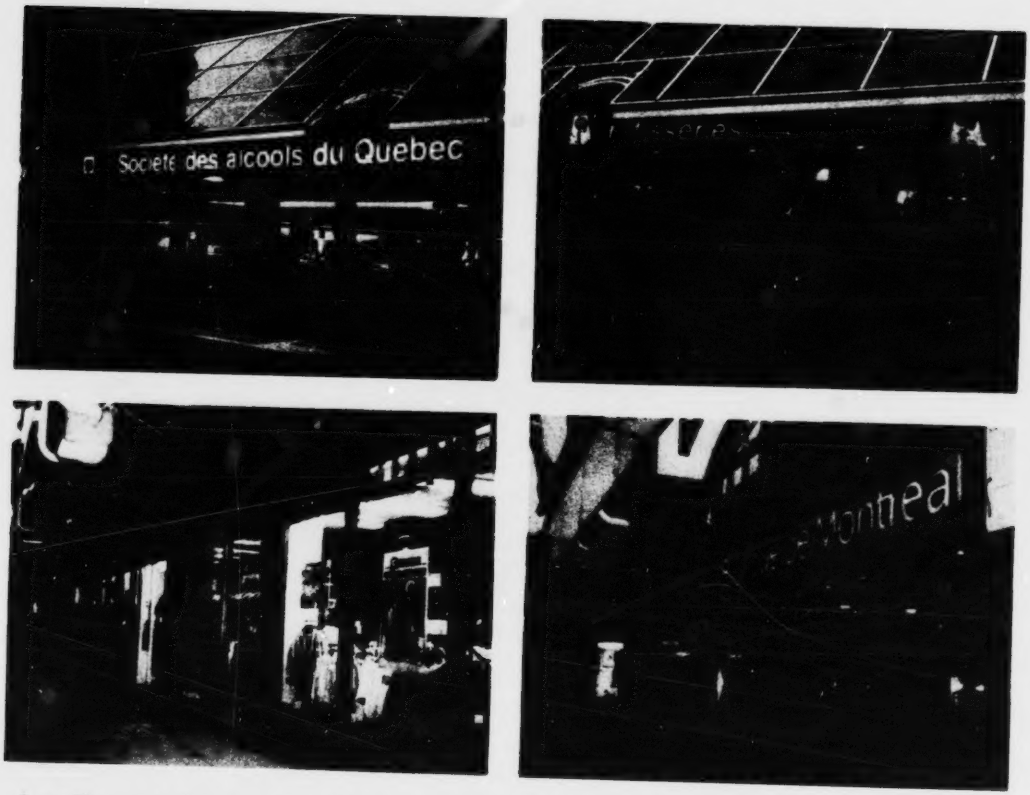
6.82 On 2 December 1983, when the agreement was signed with the sponsor, the sponsor had already acquired land, at a cost of $368,110, and signed construction contracts worth $260,810. Although a clause in the agreement stated that no payment would be made for expenses incurred before the agreement was signed, the sponsor was later reimbursed for these expenditures.

6.83 Following cost increases, CEIC, on authorization from the regional minister, altered the original agreement in July 1984, increasing the amount of the grant to $1.35 million. During the summer of 1984, however, the sponsor realized that the revised amount would still be insufficient to carry out the project in accordance with the plans and specifications. The sponsor therefore decided to cancel some of the work specified in the construction contract, including landscaping, woodwork finishing, painting and floor coverings, so as to stay within budget.

6.84 It was only in the spring of 1985 that departmental officials became fully aware of the situation. Although the project was far from completion, CEIC had already given out $1,287,828 of the grant. Without the estimated $400,000 needed to complete the work (excluding the cost of operating the museum), the sponsor wanted to abandon the project and was ready to rent the building or to give it up entirely.

6.85 Following hasty negotiations with the sponsor in the summer of 1985, the Government of Canada, through the Department of Public Works, agreed to acquire the museum for the amount of the corporation's accumulated debts – about $75,000. Public Works is now examining various options to allow other federal departments to use the building. Departmental officials told us that significant costs would be involved in modifying the building so it could be used as something other than a museum.

Case No. 3 – Store Signs



A mall association was granted $1. 2 million to hire unemployed workers to enhance the look of the mall. New signs were put up, but a large firm was contracted to do this work. It is questionable whether jobs were created for the unemployed (see paragraphs 6.86 to 6.90).

Issues: **No evaluation of the project's effects on job creation for the unemployed; no effort on the part of the sponsor to encourage hiring of the unemployed; no assessment concerning enhancements to the value of private property.**

Description and Observations

6.86 On 8 November 1983, CEIC signed an agreement with a merchants' association in a large urban centre for a grant of $1.2 million toward a $8.631 million project to build shelters covering the sidewalks of one of the city's commercial streets. According to the sponsor's estimates, the project was to create 8,840 work-weeks.

6.87 Under the program terms and conditions, the project required and received Treasury Board approval. Because of the jurisdictional conflict between the federal and provincial governments, raised by the fact that the federal government was funding a municipal project, the sponsor was unable to accept the funds for the project. The sponsor then proposed another project to CEIC so it could use the grant instead toward replacing commercial signs that were no longer suitable because of the new shelters. The Commission accepted the proposal and signed a modified agreement on 28 March 1985.

6.88 Although the nature of the project had changed fundamentally, CEIC did not judge it necessary to inform Treasury Board, believing that the changes fell within the scope of the project as originally approved.

6.89 CEIC did not estimate the number of jobs and work-weeks that would be created by the revised project for unemployed workers and others, or the cost per work-week created. Given that most of the work involved manufacturing the signs, which was done in a factory, it would appear that the project could not provide many jobs for the unemployed. CEIC and the sponsor were not able to demonstrate that the project did in fact provide jobs for the unemployed.

6.90 The signs have now become the property of the merchants. Among the merchants on the street are branches of banks, national and regional chain stores, federal and provincial agencies, and local merchants. In short, CEIC spent $1.2 million to defray the cost of replacing commercial signs that enhanced the value of private property, but it did not demonstrate that the funds had been used to create jobs for the unemployed.

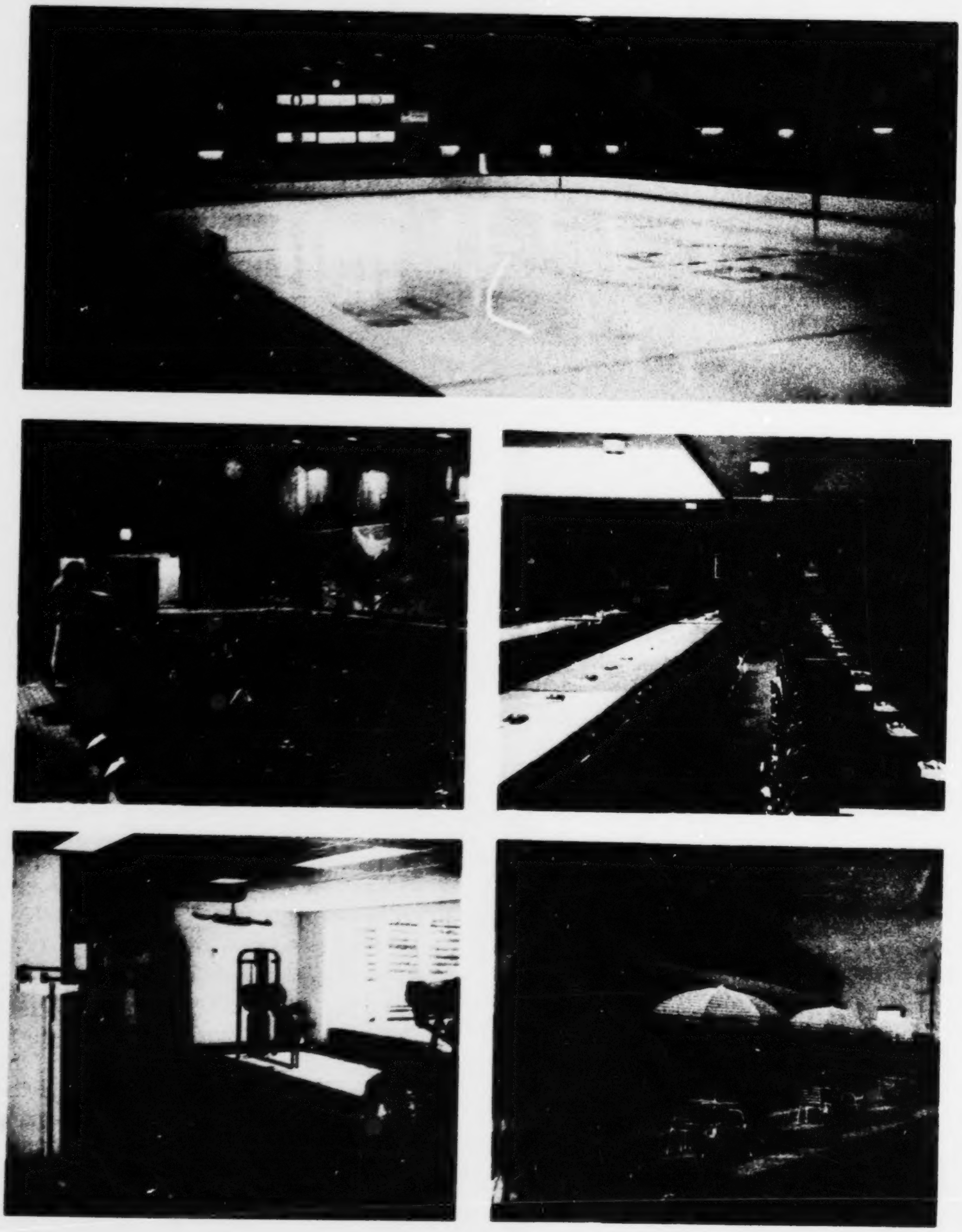
Case No. 4 – Building an Arena

Issues: **Lack of support for information presented to Treasury Board; signing of an agreement on the basis of unrealistic information; no monitoring of the project.**

Description and Observations

6.91 On 15 August 1983, CEIC signed an agreement for a grant of $1.5 million to a non-profit corporation to cover 75 per cent of the cost of building an arena. The balance was to be covered by the project sponsor. When the sponsor proved unable to provide its share of the funding, CEIC altered the agreement and, on 29 November 1983, on instruction from the regional minister, raised the grant to $2 million. As a result of cost increases and additions to the original project plans (meeting rooms, an olympic-size pool, bar, exercise rooms, sauna), the grant was increased to $4.3 million on 22 May 1984 and finally to $4.9 million on 27 March 1985.

6.92 The Minister of Employment and Immigration had presented a request to Treasury Board for authority to fund construction of the arena on 15 June 1983. That proposal had stated that the total estimated cost of building the arena was $1.5 million. According to the information in the file, CEIC already knew when it made the submission to Treasury Board that construction costs would be higher than the amount stated. The regional office had sent headquarters a detailed estimate of construction costs totalling $1,700,262 on 9 May 1983.



A project for the construction of a hockey arena for $1.5 million became a $4.9 million sports and cultural centre. The recipient of the grant did not inform CEIC of significant changes that took place during the project's several phases. The Commission and Treasury Board gave their approval after the fact, to complete the project (see paragraphs 6.91 to 6.96).

6.93 CEIC signed a grant agreement that required the project sponsor to contribute $500,000 toward the cost of the project, even though the regional office had already determined that the sponsor could not raise that sum.

6.94 Our review of the file showed that CEIC became involved in a project that was much broader in scope than that envisaged in the original proposal. With a grant of only $1.5 million and no other source of funds, the sponsor signed an agreement on 7 July 1983 with a construction contractor for $2,629,100. Under the contract, work was to begin on 11 July 1983 and be completed in two stages – the arena and a portion of the central building ($1.825 million), and the balance of the central building and the community meeting rooms ($804,000).

6.95 In the fall of 1983, construction of the arena was stopped because of delays in delivering materials. The sponsor took it for granted that the portion of the $2 million grant already approved by Treasury Board, but not yet spent on the arena, could be used to build the meeting rooms; it began constructing them. The sponsor was therefore in the position of having spent the entire $2 million grant, but neither the arena nor the meeting rooms were finished. Treasury Board then approved the funds necessary to complete the project.

6.96 According to documents in the file, the Member of Parliament for the riding and members of his family played an active role in initiating and running the projects. After leaving public life, the former MP was appointed president of the corporation and now administers the sports centre.

Local Employment Assistance and Development Program

Background

6.97 The Local Employment Assistance and Development program (LEAD) was part of the direct job creation program. Cabinet approved a new general job creation policy in April 1983. Under this policy, 3 of the 12 job creation programs then existing were merged to form LEAD. The new program fell under the broad objective of assuring the long-term growth of jobs in sectors subject to chronic unemployment. LEAD was oriented toward permanent job creation in areas suffering from continuing high unemployment rates. These programs endeavoured to create businesses, enterprises and infrastructures in small communities with limited economic growth opportunities.

6.98 Community development organizations in communities of fewer than 50,000 residents were eligible for LEAD benefits through LEAD "corporations" or LEAD "projects".

6.99 In the case of LEAD corporations, development organizations representing community interests received grants and contributions to stimulate the creation of permanent jobs. The corporations provided planning, technical and professional assistance to local businesses. The corporations received contributions to offset their salary and other operating costs. They also received grants that were to be used for making loans or equity contributions to local businesses. These loans were to be recovered by the corporations and used for reinvestments. Thus, the grants fund was to provide the community, through the LEAD corporation, with a growing pool of investment capital that could be accessed by local business on a revolving basis.

6.100 For LEAD projects, community organizations received contributions to carry out projects of three types: planning projects to analyse the current situation in a community and to establish an action plan for the future; enterprise projects aimed at increasing the number of permanent jobs by establishing new businesses; and infrastructure projects designed to provide facilities that would promote permanent jobs in the area.

6.101 LEAD program expenditures, over the two and a half year duration of the program, amounted to over $188 million. However, the LEAD program will continue for some years to come.

6.102 We examined the program terms and conditions and operational guidelines, as well as the management process and controls in place for the LEAD program. We audited a sample of 71 of the 737 LEAD corporations and projects, representing $36.5 million, or 19.4 per cent of the total program expenditures. The sample was selected at random, taking into account important characteristics of the group as a whole. We met with eight recipients.

Evolution of the Program

6.103 LEAD represents the type of job creation program that continues to exist through changes in policies and strategies. Thus, in less than three years, CEIC twice announced new programs for permanent job creation. These changes were to give Canada new job creation strategies and offer better ways of fighting the country's unemployment problem.

6.104 In 1983, three programs were grouped to form components of LEAD. In 1985, CEIC announced a program entitled Community Futures. Two of its five components are designed to carry on the work of parts of LEAD. The other three components were in early stages of development and implementation at the time of our audit. The program is being implemented in 1986. Exhibit 6.5 summarizes the objectives of the programs and the components of them that proceeded and succeeded LEAD.

6.105 Each time, the new programs were backed up by major public relations efforts and prompted considerable implementation and restructuring activity, both at CEIC headquarters and in the regions. Sometimes, these major efforts to introduce the changes caused funds to lapse. According to our analysis of the programs preceding LEAD, despite appearances, there was no fundamental change to the objectives and operational procedures. It was more a question of a new format where three programs became components of another program. Two of the components of the new Community Futures program show in their terms and conditions strong similarities with two of LEAD's components.

Exhibit 6.5

EVOLUTION OF LEAD PROGRAM

	Duration	Objective	Operation	Annual Budget Distribution
Previous Programs	1972-83	Permanent job creation in designated ridings and for target groups.	Provided funds to set up viable businesses. Provided financial, technical and professional assistance to private sector business through corporations. Developed economic infrastructure of communities.	Contributions: $64.2 million[1] Grants: $ 1.3 million
LEAD Program	1983-86	Permanent job creation in communities suffering chronic unemployment.	Same as above.	Contributions: $49.2 million[2] Grants: $16.2 million
Subsequent Program Components - Business Development Centre - Community Initiatives Funds	1986	Growth and maintenance of permanent jobs and provision of worker adjustment measures.	Funds to private sector businesses. May include cost-shared infra-structure-type projects.	Contributions: $57 million[3] Grants: $34.5 million

Notes:
[1] Amounts are for the last year. Part III, Main Estimates, 1983-84.
[2] Average over the three-year duration of the program.
[3] Main Estimates, 1986-87, for the Community Futures program.

6.106 Our examination of the files showed that a substantial number of LEAD projects and corporations had benefited from one or two earlier programs that were also aimed at increasing the number of permanent jobs. We found that 16 of the 21 LEAD projects and 8 of the 18 LEAD corporations we examined had received money from previous programs. As a result, several projects were still modelled along the lines called for in the earlier programs – for example, they were oriented mainly toward target groups, such as native people, that were the focus of those programs. Under the regional program plans for recent years, significant portions of the budget were devoted to supporting prior commitments to these older projects. The 1985-86 plans for Quebec and New Brunswick, for example, allotted 70 per cent of their budgets to funding the renewal of projects and associations. In Saskatchewan, the figure was 100 per cent.

6.107 Our examination of program terms and conditions revealed few changes in the shift from the job creation activities of one program to the next.

6.108 However, we noted an evolution toward greater flexibility with the introduction of the new program components, with fewer control requirements and more generous conditions for grants and contributions.

6.109 The only changes in the terms and conditions of the new program to replace LEAD is that they are more flexible and the financial terms more generous for recipients. For example:

- only projects connected with businesses have to create jobs;
- there is no upper limit on contributions in one program component;
- there is no upper limit on operational expenses, except for salaries, which are limited to 50 per cent of total costs;
- a corporation can now get an annual grant of $400,000 rather than $350,000 in its fourth and fifth year;
- a corporation can make loans of up to $75,000 instead of $25,000; and
- audited financial statements are no longer required.

6.110 However, the Commission advised us that the operational guidelines and contractual agreements will build in required controls.

6.111 We saw no evidence of program analysis or evaluation that would support the decision to make these recently implemented local job creation components more flexible or to allot more funds to them, as is now being done.

6.112 **CEIC should ensure that any changes in programs are backed up by evaluations and analysis of results achieved in previous programs.**

> *Commission's response*: *CEIC rejects the analysis on which this recommendation is based, namely that there were only minor changes between LEAD and previous and subsequent programs, with these minor changes not being backed up by evaluations and analysis of results. CEIC believes the Auditor General's analysis is particularly misleading in its evaluation of LEAD and the successor program, Community Futures. The analysis does not make it clear that there were three quite distinct elements to LEAD, only one of which was continued, in a modified form, in Community Futures. LEAD infrastructure and enterprise projects were dropped, while LEAD Corporations, which were successful, were incorporated in Community Futures. Community Futures represents a major departure from earlier programming in terms of local responsibilities for deciding among program options. Of the five Community Futures program options, only one, the Business Development Centre which is modelled on LEAD Corporations, is a continuation of a LEAD program element.*

The cost per job created for LEAD infrastructure and enterprise projects was very high. Ongoing monitoring and studies pointed out major problems, some of which are referred to in the Auditor General's Report. In addition, analysis of similar programming in other countries was undertaken, and a study was conducted by the Nielsen Task Force. These all pointed clearly in the same direction - that parts of LEAD were not effective (enterprise and infrastructure) and other parts were very promising (Corporations). Community development is a difficult and risky business, and when LEAD was introduced, CEIC believes it made sense to try out the three approaches. It also believes that it was right to discontinue two of those elements when experience demonstrated that they were less effective than other program directions.

Job Creation: Operational Definition

6.113 The main purpose of the LEAD program was to increase the number of permanent jobs. Although the program contained some elements of an operational definition of this objective, they were not sufficient for purposes of implementing the program effectively and accounting for results.

6.114 The terms and conditions and operational guidelines state several times that the jobs created should be of a permanent nature. For example, grants to LEAD corporations could be used only to assist business endeavours that create either full-time or part-time continuing jobs. The operational guidelines emphasize the creation of avenues of employment that are "viable over the long term," increasing the number of "continuing jobs." The meaning of these terms is not further clarified. Another example of unclear definitions is where permanent jobs were defined as jobs where people work full-time or part-time for an indeterminate period or at regular intervals.

6.115 The absence of clarity about defining the program's purpose was evident in the fact that there was uncertainty in the definition of the term "permanent job" and in the accounting for the number of such jobs. This was reflected in the analysis of project proposals and in the assessment of project results.

6.116 In the regions, we observed that there was confusion about the main objective of LEAD. We saw that the first priority of program managers was not to fund proposals on the basis of their potential to create permanent jobs. For example, there was no distinction made between the creation or the maintenance of a job, whether or not of a permanent nature. For an infrastructure project, we were informed that the program conditions did not require that permanent jobs be created directly. We were also informed that managers did not have to follow up on the permanent jobs created by these projects, and that permanence in the jobs created by planning projects was not an objective.

6.117 There was no performance indicator in the management information system relating to the number of permanent jobs created. The indicators in place related to the number of work-weeks. Although using work-weeks was a useful measure, a more appropriate indicator for the LEAD program would have been one providing information on the number of actual jobs created and how many of them were of a permanent nature.

6.118 LEAD corporations reported to the Commission the number of jobs that had been created indirectly through their efforts. We observed that CEIC had no way of verifying the validity of this information. Its management information system did not capture the number of these indirect jobs.

6.119 **To ensure that implementation of job creation programs is directed toward their primary objective, CEIC should provide clear operational definitions of what constitutes permanent job creation, and should establish performance indicators to provide information about the actual number of permanent jobs created.**

> *Commissions's response*: *CEIC does not accept the premise of this recommendation. Defining objectives was not a problem in LEAD. The Report itself lays out the definition of permanent jobs in paragraph 6.114.*
>
> *In LEAD, CEIC was trying to work with three entirely different approaches (components) to achieve the objective of permanent job creation. It was doing this in communities which, by definition, had chronic problems of high unemployment. Government programs had to create jobs both directly and indirectly. The jobs created would include part-time and seasonal jobs as well as full-time year-round jobs, and the definition necessarily had to include all these types of employment. CEIC plans to improve its measurement of the direct employment impacts under Community Futures. But, it must also be noted that the rigorous measurement of the permanency of jobs created directly and indirectly would be very costly and impractical because it would involve repeated surveying of the individuals holding the jobs over many years.*

Continuity and Self-sufficiency

6.120 The aim of the LEAD program was to provide assistance to create viable and continuing employment in regions of slow economic growth. The various components of the program have a common theme: creating a technical capacity within communities to allow them to identify and help them implement job creation initiatives and start new businesses, and providing financial support for investment purposes. Continuity and self-sufficiency were also implied in the objectives to support initiatives and businesses that show long-term viability. In our view, this also implies that businesses would become profitable at a given time and would not require additional infusions of public funds. The inability to become profitable would therefore be a serious obstacle to creating permanent jobs.

6.121 **LEAD corporations.** The terms and conditions approved by Treasury Board for LEAD corporations stated that CEIC could provide money in the form of grants and contributions for up to five years, or to a maximum of $2.1 million. The 1986 program also involves funding for a maximum of five years. Under the terms and conditions of this initiative, many LEAD corporations can continue their existence. By retaining the five-year funding period, it appears that the Commission believes that this is an appropriate period for a corporation to establish an investment portfolio and a regular clientele, so as to assure continuity and self-sufficiency.

6.122 Our audit showed that the terms and conditions and the operational guidelines did not clearly address the question of the continuation and self-sufficiency of these corporations beyond the five-year or $2.1 million limit for grants and contributions. The following are among the issues requiring clarification:

- Is it expected that corporations will continue to operate as non-profit organizations under their existing articles of incorporation after the financial or time limits have been reached?
- Should the corporations become self-sufficient by virtue of revenues arising from the funds they invest given to them as grants and/or through financial contributions from other sources?
- Once CEIC has ceased its involvement with a corporation, what steps can it take to ensure that investment funds are not used inappropriately and that funds continue to be used for job creation?
- Are corporations obliged to continue to operate under existing arrangements approved by CEIC, or can these be changed once CEIC withdraws? For example, can boards of directors approve larger loans than CEIC allows or can corporations become for-profit organizations and declare dividends for shareholders?

6.123 Our audit included an assessment of the performance of a sample of LEAD corporations to see whether they had the capacity to become self-sufficient. We observed that 7 of the 18 had reached their fifth year of operation and had each received over $1 million from CEIC in the form of contributions and grants. We noted that all seven corporations would have difficulty surviving beyond the fifth year without continuing funding from CEIC or other sources.

6.124 **Enterprise projects.** The conditions were that an enterprise project "must demonstrate that it will progress toward viability and increase ongoing employment within the framework of a community plan" in terms of its potential for profit, its cash flow and its projected revenues. Before renewing annual funding, the Commission evaluated the viability of enterprises.

6.125 Our audit of 21 enterprise projects showed that 9 of them had not demonstrated their viability, as shown in Exhibit 6.6.

6.126 We observed that, even over the five years when these nine enterprises were receiving contributions, their viability was questionable. Additional contributions were approved for them each year. Approval was based on projections and forecasts supplied by the recipients that were neither realistic nor reasonable. These cases show that there was an inadequate capability within CEIC to conduct realistic evaluations of proposals to renew funding for enterprise projects. A regional assessment committee, including both CEIC and non-CEIC members, had a responsibility for assessing project submissions. This mechanism also did not ensure that realistic evaluations took place.

Exhibit 6.6

VIABILITY OF LEAD ENTERPRISE PROJECTS

Project Status	Number of Projects Assessed	Average Number of Years of Existence	Average Funding per Project	Predicted Survival and Achievement of Self-Sufficiency
Not Viable	5	5	$651,400	- 4 enterprises shut down. - Funding for 1 enterprise cut off when it was judged not viable.
Viability in Jeopardy	4	5	$694,083	- 4 enterprises in serious financial difficulty.
Considered Viable at Present	3	3	$845,000	- 1 enterprise reliant on a single client, a provincial department. - Second enterprise had to have financial reorganization (creditors received 30 cents on the dollar). - Third enterprise viable but not conforming with terms and conditions approved by Treasury Board.
Viability Not Determined	9	3	$514,000	- 4 enterprises did not grow financially because of problems with sales, marketing, etc. - The other 5 are still dependent on LEAD funds and have not demonstrated their viability.
Total Enterprise Projects Examined	21			

6.127 We observed that large sums of money were given to non-profit organizations that had no previous business experience. The design of the program provided for five-year funding, which acted as a disincentive for these organizations to become self-sufficient.

6.128 **Infrastructure projects.** The rules were that infrastructure projects should eventually lead to permanent jobs when the activities that the projects were designed to support were carried out. To achieve this objective, however, there should have been some assurance at the outset that the projects would become viable once they were developed; that is, that the private or public sector would use the facilities to create permanent jobs. Nevertheless, there were no eligibility criteria specifying that this assurance be obtained. We found no evidence that, once funding of an infrastructure project ceased, any follow-up was done to see whether the project survived or whether permanent jobs were created.

6.129 **Causes of problems.** We attribute the problems described above to three main deficiencies that affect the achievement of the self-sufficiency of the projects and corporations: the project assessment and selection process; inadequate management of projects by the recipient; and a lack of requisite knowledge on the part of program officers. Some examples of problems noted are as follows:

- Project proposals did not include an analysis of long-term financial forecasts or of the potential for creating long-term permanent jobs.
- There was a lack of challenge by CEIC of recipients' overly optimistic sales projections.
- The program officers did not have sufficient technical and financial background to monitor and follow up on the corporations and projects.

6.130 **CEIC should specify clearly its requirements with respect to:**

- **the continuation and self-sufficiency of projects and corporations to which it provides long-term financing; and**
- **the use of grant money after the agreement between a corporation and the Commission has ended.**

Commission's response: *With respect to the first point in the recommendation, CEIC is no longer starting Enterprise projects (direct funding of business projects) and, for those which are currently operating, is in the process of developing clearer standards for measuring progress toward self-sufficiency. The result will be that existing projects will have more clearly defined performance goals. CEIC decisions to continue or discontinue funding will become more objective.*

CEIC, in introducing Community Futures, has been precise about the duration of funding to Business Development Centres and existing LEAD Corporations. Under Community Futures, for example, a Business Development Centre could receive funding for up to 5 years, subject to annual review and approval, after which federal funds will be withdrawn.

It is expected that, in that period, the community will determine the degree of benefit which the Business Development Centre has provided and will continue to operate the Centre by finding other sources of funding for its administration. CEIC looks at the continuation of the service as a matter for local initiative. Whether the Centre maintains the same level of service, grows or diminishes will be largely a matter of the degree of commitment by the community.

With respect to the second point, CEIC's agreement will, as before, require the Centre to be incorporated as a non-profit corporation. This requirement has the effect of ensuring that, in the event of a wind-up, the Corporation's assets cannot be distributed to individuals. Assets must go to another non-profit corporation. However, the matter of a Centre's use of grant funds after the agreement has been concluded will be reviewed by CEIC.

CEIC would like to make the general observation that the kind of community development undertaken by LEAD is a risky business. This is the experience of other countries and the experience of the Canadian private sector in monitoring new initiatives. There is no simple formula that can determine the self-sufficiency of projects.

Monitoring and Follow-up

6.131 The terms and conditions of the LEAD program, as authorized by Treasury Board, formed a basis for monitoring and following up on contributions and grants made. In response to an observation in the Auditor General's 1983 annual Report about the absence of financial controls in three job creation programs, CEIC published a national manual on monitoring grants and contributions agreements in September 1985.

6.132 The projects and corporations we examined were monitored, proposals were properly prepared, and the necessary approvals were generally obtained. The allowable limits on grants and contributions and the terms and conditions governing payment methods were generally respected.

6.133 The audit showed instances of non-compliance with respect to financial statements, project visits, control of expenses and revenues, and projects with other sources of funding:

- Half the enterprise project files we examined contained no audited financial statements, as required by the program terms and conditions.
- In 11 of the 71 files examined there were no reports on the required financial monitoring visits by program officers.
- Reports on these financial visits did not indicate which expenses and revenues were examined by the visiting program officer, and reviews did not indicate the scope of the expenditures verified. There was therefore no assurance that funds provided under LEAD were being used appropriately.
- In 11 of 21 enterprise project files examined, reports on financial visits gave no indication that the CEIC project officers had verified that all revenues were recorded on the sponsors' books. In these cases it was not possible to establish whether unrecorded revenues might have reduced the amount of the contribution required from LEAD.
- We observed LEAD projects receiving funds from other CEIC programs, other federal and provincial departments, and other organizations. In these cases there was the risk that the jobs created by the project were reported more than once.
- In 16 of 46 enterprise and infrastructure project files, although there was funding from other sources, it was not mentioned in the sponsor's proposal or in the agreement between the sponsor and CEIC. Therefore, CEIC had no

appropriate means of monitoring the impact of its contribution on the overall project and what results it achieved.

6.134 CEIC should conform with its own project control and monitoring requirements and ensure that it monitors the results achieved by its contributions in relation to the total contributions for projects receiving funds from other sources.

Commission's response: CEIC will review its conformity with established project control and monitoring requirements. Mistakes have been made and the requirements may not have always been implemented uniformly across CEIC's large, decentralized organization.

With respect to the second point, CEIC makes contributions for specific costs identified in a budget, and payments are made on a reimbursement basis. Under Community Futures, even greater emphasis will be placed on shared responsibilities for local development and, at a minimum, program information must clearly identify the activities of CEIC partners.

Case No. 5 – Coffin Manufacturing

Between 1982 and 1986, CEIC contributed $395,976 to an organization to set up a viable enterprise and create permanent jobs making and marketing fibreglass coffins. To date, only one has been sold – for $400 (see paragraphs 6.135 to 6.141).

Issues:

No technical and financial analysis of viability of enterprise at proposal evaluation stage; no technical capacity to diagnose and correct financial, production and marketing problems; permanent job creation objectives not achieved.

Description and Observations

6.135 In 1982, an organization received a contribution of $21,073 to study the feasibility of establishing a viable business venture. The result was the launching of a company to manufacture fibreglass coffins. An agreement covering 1983-84 provided for funding up to $213,000. However, the project started on shaky ground and a contribution of only $7,000 was made.

6.136 Over a four-year period, CEIC paid out $395,976 to the company under three different programs and from its departmental reserve.

6.137 The objective of the Enterprise Projects component of the program was to create businesses that were likely to become viable and thus to create continuing employment opportunities.

6.138 Given the information in the project file, there is reason to question the quality of the initial and annual evaluations of the project proposals, both from a financial perspective and in view of the potential success of this kind of enterprise in what is essentially a tradition-bound industry.

6.139 In 1984-85, the first year of actual operations, funding of $197,292 was provided. Sales of $49,910 had been forecast; the sponsor was supposed to contribute $51,250. However, the only revenue recorded over the year was interest in the amount of $5,689. The company encountered all kinds of production and marketing difficulties.

6.140 In January 1985, CEIC officials recognized that the project was in serious financial difficulty. Nevertheless, when the company presented a request for an additional funding period, the minutes of the meeting of the Regional Assessment Board for 27 February 1985 showed that the Board, "in reviewing the proposal, expressed no major concerns and recommended (name of company) for a second year of funding". CEIC gave $132,036 in additional funds. The regional program managers did, however, specify monthly budget analyses, as well as sales reports. The agreement specified that the expenses amounting to $403,024 would be offset in part by sales of $256,320. We found only one sales report in the file, for April 1985; only one coffin was sold at a price of $400. This project was found not to be viable in June 1985 and, in January 1986, CEIC ended its contribution.

6.141 When we visited the project sponsor in early 1986, only 2 employees remained, out of 10 permanent jobs the project was supposed to create.

National Institutional Training Program

Introduction

6.142 Over the last five years, the National Institutional Training Program has been CEIC's largest single program after the Unemployment Insurance Account. Over 200,000 Canadians a year have benefited from this program by receiving adult training in places purchased by the federal government in provincial vocational training schools, colleges or technical institutes. Trainees also often receive income support while taking training on a full- or part-time basis. Participants can take a range of courses that could involve skill training, such as welding, secretarial work, or cooking; language training; upgrading of basic skills in mathematics, science and communication; job readiness training; or apprenticeship.

6.143 In 1985-86 alone, 151,000 Canadians full-time, and 55,000 part-time, benefited from the program. Approximately 14 million training days were purchased at a cost of $521,042,000. This expenditure makes up 56.5 per cent of the Institutional Training Program; the remainder is made in the form of payments of benefits to trainees either as training allowances ($153,623,000), unemployment insurance benefits under section 39 of the Unemployment Insurance Act ($234,800,000), or trainee travel allowances ($12,177,000).

CEIC's institutional training program, designed to enhance employability and income capacity, cost $921,642,000 in 1985-86 (see paragraph 6.143).

Current Status

6.144 As of 1 April 1986, Institutional Training no longer exists as a separate program but has been incorporated under the Canadian Jobs Strategy. A series of new agreements with the provinces is expected to define this integration. The previous agreements between the federal government and the provinces and territories, signed in 1982 under the National Training Act, expired in March 1985; they were extended to the end of March 1986.

Scope

6.145 The scope of our audit covered the Institutional Training Program, as set out in the National Training Act, for the 10 provinces. We examined:

- the planning and budget allocation processes;
- negotiations of course prices and payment for purchases;
- procedures to measure and report program effectiveness; and
- selection of trainees and payment of allowances.

6.146 We asked the Commission to arrange meetings with provincial program representatives. These were held in all provinces except Quebec and British Columbia, where meetings could not be scheduled due to the stage of the negotiations for the new agreements.

6.147 In examining the selection of trainees for training under the program, and the payment of income support to eligible trainees, the main focus of our work was the payment of income support. In Nova Scotia, Quebec, Ontario and British Columbia, we visited the regional headquarters of CEIC and three training Canada Employment Centres.

Program Objectives

6.148 Consistent with the objectives stated in the National Training Act, the program is directed "to provide occupational training for the labour force and thereby to better meet the need for skills created by a changing economy", and "to increase the earning and employment potential of individual workers." The Commission purchases training courses to meet these objectives. Specific purchase decisions, however, are made by the federal and provincial governments together, through a series of joint committees.

6.149 The Commission reports on the success of its program particularly as it relates to training in occupational skills, since this type of training is most directly related to the program's objectives. In 1984-85, 37 per cent of full-time trainees took courses in occupational skills and 30 per cent in apprenticeship. The other trainees were in courses such as basic skill training, language training and job orientation training.

6.150 We noted some limitations in the measures used by the Commission (see Program Evaluation section). The measures used for 1984-85, during a period of high unemployment, indicated some difficulties in attaining the objectives:

- **Measures of success in meeting labour market needs:**
    - 27 per cent of the skill trainees took training in occupations that were designated of national importance because they are, or are potentially, in serious short supply.
    - The most recent program evaluation estimates that over 50 per cent of skill training is in occupations where there are surpluses at the time the trainee graduates.
    - 44 per cent of the trainees in skill training were not working 90 days after completing their course. Of those working, half were working in areas directly related to their training.
- **Measure of success in increasing individual earning and employment potential:**
    - The program evaluation for 1983 graduates found, on average, that there was no significant increase in earning or employment potential for a group of trainees in occupational skill and basic skill training in contrast to a comparison group of non-trainees.

6.151 As noted previously, the National Training Act sets out specific federal objectives for the Institutional Training Program; however, the program operates as a negotiated partnership with provinces and territories, as set out in 12 bilateral agreements made under the Act. These agreements provide a guaranteed amount of money that will be spent on training, regardless of labour market needs. The agreements limit the amount of purchases from private institutions and specify that all decision making with respect to the program is to be based on a federal-provincial consensus.

6.152 While provincial governments share the Commission's objectives of meeting labour market needs and increasing individual earning and employment potential, they also have an objective of maintaining a stable and continuing institutional training system. To maintain these institutional structures, governments have come to rely on federal training purchases to provide a significant portion of the funding in the provinces and territories. It is estimated that federal course purchases are equivalent to approximately one-quarter of the operating costs of community colleges and vocational training institutions.

Planning and Budget Allocation

6.153 As laid out in the bilateral agreements, the planning and subsequent purchase of courses are carried out jointly based on a process of discussions and negotiations to arrive at a consensus position. The audit examined the planning and budget allocation process on the federal side within the context of the agreements.

6.154 In all regions, we found that the labour market analysis and the success of previous graduates were used to some extent in choosing specific courses for purchase. However, the usefulness and the impact of this input on course purchases were not assessed.

6.155 As set out below, a number of factors were identified that made it difficult to ensure that the funds provided for purchasing training were being used effectively. These include the method of budget allocations, the effect of perceived purchase commitments on current year budgets, and a lack of clear and consistent central direction on purchasing training for jobs of national importance.

6.156 **Budget allocation.** We examined the budget allocation process used in 1985-86 to determine the extent to which program objectives influenced the allocation of funds. We found that the minimum guarantees of 90 per cent of the previous year's allocations in the agreements with the provinces are the most important influence on budget allocations; the Commission's discretion in allocating funds is limited to any excess over the guaranteed minimums. The amount of this excess is shown below:

	1982-83	1983-84	1984-85	1985-86
Allocation ($ millions)	490.2	523.9	522.2	522.5
% over the guarantee	8.8	7.6	7.9	9.6

6.157 The Commission established a set of performance-based criteria to allocate funds to the provinces and territories for 1984-85 and 1985-86. Although these criteria were used in the 1984-85 budget allocation, the budget allocation for 1985-86 did not use them in the way they had been communicated to managers. Based on decisions external to the Commission, an allocation was made that provided provinces with an amount not less than their 1984-85 base allocations. In effect, the method of allocation in 1985-86 took funds (approximately $13.5 million) from provinces that had met performance criteria and gave it to those that had not.

6.158 **Effect of perceived purchase commitments on current year budgets.** In some regions, the funds available for purchases each year are further constrained by perceived "moral commitments" by program managers to purchase courses from specific training institutions that had received funding under the Skills Growth Fund. This was a separate program under the National Training Act to provide funds for building facilities and purchasing equipment for training in jobs of national importance. There was no legal commitment to purchase courses from institutions that had received funding, unless the training program criteria for course purchases were met.

6.159 We found that the greatest inconsistency between current labour market needs and training purchases existed in purchases being made from some of the institutions that had originally been established under the Skills Growth Fund during 1982-85. We found a number of examples where there was no longer a labour market need for training in areas where previously there had been an occupational shortage or where similar training could be obtained elsewhere at a lower cost from other institutions. But purchases continued to be made because of this perception of a moral commitment to the institutions. Some examples are noted in the following paragraphs.

1985-86 Per Diem

	Skills Growth Fund Institution	Comparable Provincial Institution
British Columbia	$ 120.00	$ 52.00
Saskatchewan	200.00	55.00
Manitoba	70.00	41.00

6.160 A training centre in British Columbia was started as a private, non-profit society, funded by the Skills Growth Fund to give courses designed to provide specialized high technology metal trades training. Because of changes in the economy and in industry needs, these courses are no longer being given. The centre now continues to operate by providing courses that are available at other institutions at lower costs.

6.161 A technical training institute in Saskatchewan was incorporated as a non-profit society and received funding from various federal sources, including the Skills Growth Fund ($2 million) and the Employment Creation Grants and Contributions ($115,000). It was built by native people for training native people in the oil and gas industry. The demand for occupations in the oil and gas sector has dropped significantly. The training at the institute in 1985-86 was almost four times the cost of similar training elsewhere due to costs incurred for course development; projected costs for 1986-87 are twice the cost.

6.162 A technical training centre in Manitoba was established through the Skills Growth Fund with training provided by a private company but administered by the province. The centre was established to meet anticipated needs for training in computer technology. The requirements for such training have changed, resulting in the delivery of comparatively expensive training that costs $29.00 more per day than similar training offered at other provincial training institutions.

6.163 We found that maintaining these "moral commitments" by some regions resulted in uneconomical purchases and unnecessary reductions in purchases that could otherwise have been made to meet current labour market needs.

6.164 **The Commission should ensure that the purchase of courses meets current purchase criteria and that perceived moral commitments are not the basis for purchases that do not meet these criteria.**

> *Commission's response: The Commission agrees with the intent of this recommendation. Under the Canadian Jobs Strategy, the problem of perceived moral commitments will be largely resolved, since there is no provision for capital support similar to what was available under the Skills Growth Fund.*

It should, however, be noted that equal access to training by members of target groups forms part of the current purchase criteria, and "moral commitments" are often, in reality, connected to equity considerations. While transitional measures are continuing through fiscal 1986-87, to allow time for institutions to adjust, in future there will be compliance with the criteria applicable to Canadian Jobs Strategy programs, including equity considerations.

6.165 **Lack of clear and consistent central direction.** These specific purchase decisions are determined by the final budget allocation, the joint federal-provincial process of identifying training needs and the directions from national headquarters to program managers for use in the negotiations. The National Training Act defines occupations of national importance as occupations where there is expected to be a shortage of workers sufficiently serious to justify special action. In 1984-85, 27 per cent of skill trainees were taking training in occupations that were designated of national importance.

6.166 The original list in 1982-83 had 47 occupations. A specific target, defining the proportion of trainees that should receive training in jobs of national importance, was never provided by national headquarters, although an incentive to purchase this type of training was provided in the budget allocation formula.

6.167 Regional CEIC managers did not have a common understanding of the priority to be placed on the use of the designated list to purchase skill training. In Quebec, for example, the lists were one component of the input in making purchase decisions; in Ontario, a specific regional target was set by the joint committee. The lists were used differently in the regions, resulting in different levels of purchases, despite the priority placed on them.

6.168 Up to March 1984, the national list of occupations was sent to the regions at the beginning of each fiscal year when the planning for the year had just been completed. As a result, the designated occupations on the new lists could not be included in the purchase plans until a year later. In 1985-86 CEIC managers in the regions were uncertain about the status of the list of occupations, because it had been sent to the regions in the form of a preliminary list incorporating revisions to the 1984-85 list. No final approved list was sent.

6.169 **Lists of designated occupations, defining where shortages are expected to be sufficiently serious to warrant special training initiatives, should be current, fully approved and issued on time for use in planning purchases. The Commission should provide managers with clear central direction on the use of the lists of designated occupations.**

Commission's response: CEIC is already implementing the substance of this recommendation in new procedures under the Canadian Jobs Strategy. The new designation process focuses on regional designation of occupations.

Negotiation of Course Prices and Payments to Provinces

6.170 The agreements specify the procedures for program administration, including the method of payment and yearly negotiation of per diem course prices and administration costs. Through negotiating, the federal government attempts to maximize the number of training days it can purchase that best meet the Commission's program objectives and to ensure that the costs proposed by the provincial government are reasonable; that only eligible costs are included; and that greatest value is obtained for the price paid.

6.171 Within a prescribed period (12 to 18 months) after the end of each fiscal year, each province and territory is required to submit a certified financial statement that provides the basis for subsequent negotiations of prices and, for some provinces, provides the basis for adjusting underpayments or recovering overpayments.

Negotiation of Course Costs

6.172 The agreements provide for the payment to provinces and territories of an amount that represents as closely as possible the actual costs incurred in providing the course, either through the cost certification process or the negotiation of a fixed price. Because over 90 per cent of the funding is guaranteed in the agreements, and purchases are made almost exclusively from the provincial government, the reimbursement of the actual cost does not provide an incentive to the provinces and territories to supply courses in the most cost-effective manner. Nor do all regional managers systematically analyse the cost-effectiveness of alternative purchase options.

6.173 In our 1978 Report, paragraph 14.37, we recommended that the Commission strengthen its negotiation of course prices by obtaining better pricing information and strengthening financial expertise. In 1980, under the Adult Occupational Training Act, the Commission established guidelines on the annual negotiation of prices and directed regional financial officers to take a more active part in the negotiations as outlined in the guidelines included in the Commission's Financial Administration Manual. In the agreements signed in 1982 under the National Training Act, a provision was included that the province should supply relevant cost information and planning documents to the Commission.

6.174 We found that the 1980 guidelines that were prepared under the Adult Occupational Training Act have not been updated. We also noted that they were not adhered to by all the regions. For example, some regions, including Newfoundland, Quebec, and British Columbia, limited their review of the per diem prices to whether the increase requested by the province appeared acceptable. Further, there was no information available to the regional offices on approximate prices and the component costs that could be included in them, which would serve as a benchmark against which to assess whether costs requested by the provinces were reasonable.

6.175 **The Commission should update its guidelines relating to the negotiation of prices and administration of federal-provincial training agreements and ensure they are complied with.**

Commission's response: The Commission plans to update the guidelines, particularly in light of the new agreements currently being negotiated.

6.176 The Commission should include in its guidelines benchmark information on prices for each category of training course to provide a basis for each regional office to assess whether costs requested by the provinces are reasonable.

Commission's response: The Commission has refrained from setting benchmarks for course price negotiations with the provinces because of the lack of similarity between provinces and the acknowledgement in the training agreements that the cost-causing elements inherent in course offerings be under provincial jurisdiction. The vast diversity of teaching processes, teachers qualifications, class loads, etc. all but preclude national-level standardization, but statistical information on actual course costs, by type of training in each region, is put at the disposal of all regional officials in this context. CEIC, instead, is gradually moving in the direction of routing an increasing percentage of the funds for institutional training via project sponsors and private sector partners, in order to bring market forces more to bear on course purchases.

Non-compliance with the Agreements

6.177 We noted examples of non-compliance with the agreements by the Commission and by the provinces. For example, the Commission failed to advise the provinces of the annual allocation for the next fiscal year by the agreed date. CEIC also made adjustments based on cost certifications that did not comply with the methods specified in the agreements with British Columbia, Prince Edward Island and Saskatchewan (before 1985-86). Instances were also found of payments in excess of authorized maximums and payments of non-approved per diems.

6.178 **Receipt of cost certifications.** In our 1978 Report, paragraph 14.161, we noted that there were significant delays in receiving cost certifications and, in some provinces, costs were not always certified by an independent auditor. Some of these weaknesses still exist. As a result, in many cases, the Commission does not have a basis for ensuring the accuracy and eligibility of the costs charged by the province.

6.179 CEIC should ensure it complies with the terms of the agreements made with the provinces in regard to the National Institutional Training Program.

Commission's response: While it is acknowledged that complete compliance with all the details of every training agreement was not always achieved, the implications of such lack of compliance were, in CEIC's view, marginal. Some features that gave rise to departures from agreed methodology have been removed from the agreement model currently under negotiation. Generally, the new agreements are shorter and simpler than the old ones. From 1986-87 onward, course prices will be firm and final in all provinces (territories), which eliminates much of the significance of cost certification.

Procedures to Measure and Report Program Effectiveness

6.180 We examined the systems in place to monitor ongoing program effectiveness and periodic program evaluations of the Institutional Training Program.

Ongoing Program Monitoring

6.181 Through the management reporting system, a number of program performance indicators are used regularly. These include the number of training days and trainees in different types of training, the number of training positions purchased in occupations of national importance, and a follow-up of trainees 90 days after they complete their training. The 90-day follow-up survey provides one of the main ongoing effectiveness measures of graduates entering the labour force, and it is used extensively by the Commission for internal reporting, reporting to Parliament, planning purchases and allocating budgets.

6.182 Program managers, particularly on the provincial side, expressed concern that the 90-day follow-up period was too short to capture labour market success accurately. A program evaluation by the Commission has also concluded that the 90-day follow-up was not a good predictor of employment success in the longer term. For the same people, the evaluators found that the results of the 90-day follow-up survey showed little relationship with the results of the evaluation survey approximately 16 months after course completion.

6.183 Further refinement of the indicator, or a lengthening of the follow-up period, is required for it to be used as a measure of long-term employability for reporting and program management, particularly since the indicator is used in decisions about the types of courses to be purchased and about budget allocations.

6.184 **For ongoing program monitoring, the Commission should consider extending the follow-up period after the completion of training to evaluate labour market experience.**

> *Commission's response: CEIC feels that a better approach than that recommended would be to have both a shorter-term and a longer-term follow-up survey. While some of the criticism levelled at the 90-day follow-up survey has merit, this survey still represents an indispensable tool for relatively short-term decision processes. An extended period coverage simply delays the answers. Twelve-month follow-up surveys have in the past been used to augment the intelligence provided from short-term monitoring, and these will also become a regular feature for monitoring the results of Canadian Jobs Strategy programs. The results will be a comprehensive approach to monitoring that is without precedent in Canada.*

Program Evaluation

6.185 Three program evaluations on the Institutional Training Program have been produced within the last four years. Two were based on a sample of trainees that terminated their training in 1978-79 under the Adult Occupational Training Act, and the third was based on a sample of trainees that completed training in 1983-84, largely under the National Training Act. We examined the most recent study. This evaluation was based on a survey of trainees 16 months after they had completed their courses and was designed to update and extend the earlier studies.

6.186 The evaluation was limited to an examination of whether the Commission's objectives were met on a national level. Treasury Board guidelines recommend an examination of all possible evaluation questions prior to defining the area for evaluation. However, the scope of the evaluation was determined without a prior assessment of all the effects, intended or unintended, that the program might have; for example, an assessment of the savings in unemployment insurance attributable to training. Also, since the evaluation was initiated shortly after the National Training Act was passed, there was no identification or analysis of the relationship between the legislated objectives and other objectives of the program; for example, those embedded in the federal-provincial agreements.

6.187 Provincial program managers were concerned that the program evaluation had not recognized their additional objectives to maintain stable vocational training institutions and to educate a more highly trained labour force. These provincial objectives, which influenced many of the course purchases as sanctioned in the agreements, were not included as evaluation questions.

6.188 The operation of the program is based on a federal-provincial partnership. The scope of the evaluation, based on the assessment of federal objectives, did not fully capture the program activity as described in the agreements and operated on a daily basis in the regions.

6.189 The conclusions in the evaluation are generally applied to all Commission trainees across Canada. There is no indication in the report of the extent to which there may be specific exceptions to the main findings. For example, the evaluation study's assessment of occupations with surplus supplies of labour is based only on Canadian aggregate results that do not take into account local area labour market information. The analysis is also based on broad classifications that can include specific occupations, some of which can be in short supply while others are not. Similarly, the conclusion that there is no significant increase in earnings or employment due to training is generally applied to all types of training for all trainees. The analysis in the report does not attempt to isolate the effects of institutional training for particular groups of trainees in each province who may have benefited from the program.

6.190 **CEIC should ensure that further program evaluations are broad enough to include an assessment of program objectives, a complete identification of program effects and an analysis that captures the regional differences in the program.**

> *Commission's response*: *CEIC agrees that an ideal evaluation should be both broad and specific, as long as it adds to the understanding of program strengths and weaknesses, points to remedial action in a reasonably conclusive manner and does so justifying the cost of the process. CEIC is committed to the process and will take the auditors' recommendations into account for improvements of it. In*

CEIC's view, the recent evaluation is an excellent example of an approach that was thorough and that was also sufficiently timely to make a difference. The results of the evaluation influenced the new agreement.

Selection of Trainees and Payment of Allowances

6.191 In 1984-85, 95 per cent of full-time trainees received income support either in the form of allowances or unemployment insurance benefits. The total expenditure was $345.0 million.

Income Support to Trainees

Full-time Trainees	1984-85
Number of trainees started	153,646
Number of trainees receiving income support	146,213
UI payments to trainees	$ 227.2 million
Allowances paid to trainees	$ 117.8 million
Total Income Support	$ 345.0 million

6.192 Canada Employment Centre (CEC) counsellors select all trainees except apprentices, who are selected by the provinces. Almost all the full-time trainees selected are eligible for income support while training, either under the National Training Act or the Unemployment Insurance Act. Since September 1985, part-time trainees training more than 10 hours a week have also become eligible.

Compliance with Criteria for Selection of Trainees

6.193 We examined the processes for monitoring counsellors' decisions to select trainees and the documentation held on trainees to determine whether the eligibility criteria stated in the National Training Act were being complied with. These criteria state that, to be selected for training, a client must not have attended school on a regular basis for any 12 months since becoming an adult, and that the course selected should be suited to the needs of the trainee and likely to increase his or her earning and employment potential.

6.194 We found that locally developed monitoring processes were usually in place and that initiatives to improve monitoring had been taken. The eligibility criteria stated in the National Training Act were communicated to counsellors and were generally understood and complied with.

Evidence Required to Support Trainee Declarations

6.195 To enroll a trainee in a course and in the pay system, a counsellor must fill out a declaration form. While filling this out, the counsellor applies a series of income screens: is the trainee receiving wages, unemployment insurance benefits, or other forms of income?

what is the income of the trainee's spouse? These screens help determine eligibility for allowances and the level of allowance to be paid.

6.196 We found that the only testing usually done of the validity of the trainee's declaration is a check on whether he or she is receiving unemployment insurance benefits. It is largely left up to the trainee to advise the Commission of any changes in economic or family circumstances that might affect allowance entitlements.

6.197 If the trainee states that care is required for dependants, a dependant care declaration is also filled out and signed by the trainee, and supplementary allowances will be paid. In 1984-85, $17 million was paid out to trainees in dependant care allowances.

6.198 We found that some CECs require proof of the existence of the dependants, usually through production of a medical card; but this requirement was not universally applied. Further, no check is done of whether the trainees actually have to pay for the care of the dependants.

6.199 The above findings show that the Commission requires very little evidence from trainees to support these two declarations and it does few checks of their accuracy. Therefore, there is potential for misrepresentation, intentionally or unintentionally, by the trainee.

6.200 In a 1980-81 study on fraud and abuse of non-unemployment insurance income support payments, the Commission found no evidence of trainees defrauding the system intentionally; but it did find that 16 per cent of the trainees sampled were overpaid. These overpayments represented 8 per cent of the total dollar value of the sample in a year when $104 million was paid out in non-UI income support to over 100,000 trainees. The overpayments were mainly because either the trainee or the counsellor misunderstood or misapplied the rules for determining eligibility for and levels of allowance. The Commission has improved administrative controls in the area of trainee declarations, but it has not followed this study up to determine whether these improvements have reduced the incidence of overpayments.

6.201 **The Commission should conduct periodic follow-up of its 1981 study. It should also introduce an ongoing or periodic check of the validity of trainee declarations of economic and family status.**

> *Commission's response: CEIC is planning to introduce ongoing checks, and it agrees that follow-ups of the 1981 study would determine how valid trainee declarations are generally and how significant the abuse is. The positive findings of the 1980-81 study and the strengthened payment system now being introduced indicate that serious problems are not likely. However, more emphasis could be put on clients documenting their declarations for review by the counsellor.*

Accuracy of Payments to Trainees

6.202 We examined the payment histories of 433 trainees in the four regions we visited. We found that 13 per cent were overpaid, and 10 per cent were underpaid. The average error in payment per trainee over a course (on average, 18.5 weeks) was $106, equivalent to an average allowance payment for one week. In our view, these findings indicate a problem with the level of service provided to trainees in the payment of allowances.

6.203 The findings do not overlap significantly with the fraud and abuse study performed by CEIC in 1980-81. That study primarily investigated the accuracy of trainee declarations; we focused on the processing and administration of trainees' pay (we accepted trainee declarations as long as they were consistent internally and with other documents available at CEIC).

6.204 We identified three major causes for the errors in pay (see Exhibit 6.7):

- inadequately defined roles and responsibilities of the Department of Supply and Services, regional headquarters, CECs (22 per cent of sample errors) and training institutions;
- lack of quality control over clerical pay adjustments (43 per cent of sample errors); and
- poor communication between Training and Unemployment Insurance sections (27 per cent of sample errors).

6.205 We also found that, as a result of the lack of specificity in national guidelines on the detailed procedures of the system, regions and training CECs have had to develop their own methods for maintaining and monitoring the systems of trainee documentation, pay adjustment, and follow-up.

6.206 Payment to trainees is made by the Department of Supply and Services (DSS) through a service contract. We did not attribute any errors directly to the DSS pay system, because CEIC retains the final responsibility for accuracy of payments. However, it is our view that the DSS system contributed to the occurrence of errors by increasing the workload of CEIC clerical staff. For example, each CEC has developed its own system for monitoring the accuracy of DSS pay actions, and much time is spent on this monitoring and in adjusting and resubmitting pay documents. We noted that there were no performance standards in the service contract for accuracy of the pay service provided, nor were there appropriate mechanisms for monitoring that service.

Exhibit 6.7

Main Causes of Error in Payment to Trainees

We found that 23 per cent of trainees, whose payment histories we examined, were paid incorrectly, at an average error of $106, or approximately one week's regular allowance. The main causes of these mispayments were:

- **roles and responsibilities not well defined**
    - overpayments were not raised, because of confusion of roles between DSS, regional headquarters and training CECs;
    - pay adjustments made by DSS were not always checked by training CECs;
    - amendments to pay entitlements because of changed course hours or changed holidays were not dealt with because of confusion of roles between DSS, regional headquarters, training CECs and training institutions.
- **no ongoing quality control over pay adjustments**
    - unauthorized absences were not reported to DSS;
    - commuting allowances were not properly updated;
    - pay adjustments made by clerical staff were inaccurate.
- **poor communication between Training and UI sections**
    - advices of pay adjustments were not received by UI sections;
    - advices were received but no action was taken by UI sections;
    - UI sections did not feed back clear information on entitlements or adjustments to Training sections.

6.207 The Commission should take measures designed to improve the accuracy of payments to trainees by:

- **defining clearly the roles and responsibilities of the various participants in the system;**
- **expanding the guidelines available to operational staff on detailed procedures;**
- **including in those guidelines an ongoing quality control program to be conducted by supervisory staff that covers both allowance and unemployment insurance payments to trainees; and**

- **establishing an appropriate mechanism for monitoring the quality of service provided by the Department of Supply and Services.**

Commission's response: CEIC commenced, on 20 April 1986, a phased implementation to improve the accuracy of payments to trainees by introducing a major upgrading of the system operated by DSS. The points made are generally valid and have already been taken into account; steps can be taken to define roles more clearly, expand the existing guidelines and monitor the quality of work done by both CEIC and DSS.

Given the pressure on human resource levels, the accuracy of payments will continue, to a degree, to compete with the effectiveness of the counselling service itself. While we have taken steps to improve the former, priority will continue to be on the needs of the client.

Evaluation of the Effects of Income Support

6.208 In 1978, we reported that the Commission had not carried out any systematic research on the effects of providing income support to trainees. We recommended that evaluations of the effects of training allowances should be initiated.

6.209 Some research has been done whenever levels of allowances have been reviewed, but the only systematic and formal analysis was conducted as part of the most recent program evaluation on the Institutional Training Program. We reviewed the evaluation findings and the analysis supporting the most recent changes in allowance structure.

6.210 In 1985, substantial changes were made in the allowance structure. The changes resulted in an increase by 50 per cent in regular allowances, an increase in the number of people eligible for allowances, and an increase by an estimated $63 million in the total standard annual payout. While the changes led to an increase in the economic incentive to train and eliminated certain inequities in the system, the analysis supporting them left a number of questions unanswered.

6.211 For example, the Commission did not address the reasonableness of the total support that can be available to trainees. Trainees can be eligible for regular allowance or UI benefits, dependant care allowance and commuting or living away from home and travel allowances. Taken together, these can form a substantial income support package and, indeed, may be significantly higher than the wage potential in the occupation being trained for. In our sample of trainees, we found more than 5 per cent being paid more than $300 a week, with an average weekly rate in that group of $373.

6.212 The 1985 program evaluation briefly examined "whether existing income support levels constitute an incentive or a disincentive to take training ..." and concluded that the existing levels were at least adequate to provide an incentive to take training. The two key findings presented were that only 5 per cent of trainees that discontinued courses cited financial reasons, and that 72 per cent of trainees stated they would have taken training for less or no income support (27 per cent would have taken it for less, 45 per cent for none).

These findings are inconsistent with arguments made in the subsequent review that there was a need for increases in the economic incentive provided by allowances. The Commission has not followed up, validated or expanded these findings, which raises questions about the whole income support structure.

6.213 The Commission should follow up the 1985 evaluation findings and evaluate more fully the effects of providing income support to trainees.

> Commission's response: *The 1985 evaluation was a major Canadian contribution to the evaluation of a labour market program. Future evaluations will pay even more attention to the income support aspects. It is important to note that the recent evaluation indicated that income support was adequate for existing participants. The objective of the increased allowances was, however, to encourage training of new categories of recipients, notably those who are presently under-represented and who are most in need of the training.*

Grants and Contributions

6.214 In Chapter 12 of our 1977 Report, we described several problems with respect to the distinction between grants and contributions. One of our recommendations at the time was that "a special effort be made to minimize the number of grants". Subsequently, the Treasury Board issued new directives on grants and contributions and, for some time, the use of grants was minimized in departments, including CEIC.

6.215 During this year's audit, we observed that, before 1981-82, CEIC used mostly contributions to fund job creations projects. The Commission later asked for and obtained approval to use grants, first in the ECGC program and later in the LEAD corporations program. Exhibit 6.8 shows the growth of grants in recent years.

Exhibit 6.8

Job Creation Grants

Fiscal Year	Grants ($ thousands)
1981-82	962
1982-83	5,654
1983-84	43,440
1984-85	123,220
1985-86	53,893

Source: 1981-82 to 1984-85, Public Accounts; 1985-86, Main and Supplementary Estimates.

6.216 We found some justification by the Commission to support the use of grants to fund ECGC projects and LEAD corporations. However, it did not address the question why grants were more advantageous than contributions in terms of achieving program objectives.

6.217 Under Treasury Board policies, grants and contributions are payments made to recipients from whom the government receives neither goods nor services. Payments in the form of grants are unconditional and include no audit requirement; contributions are conditional payments, subject to audit, that are covered by agreements setting out the terms and conditions of payment.

6.218 The definition of grant set out in Chapter 9.4 of the Treasury Board Guide on Financial Administration is open to interpretation. Interpreted broadly, Treasury Board directives would allow the payment of grants without any obligation on the part of recipients and without any audit of funds thus distributed to ensure that they were spent for the purposes intended. Interpreted narrowly, controls to ensure that grants are spent for the purposes intended could be the same as those for contributions. The directives do not oblige the parties to sign a grant agreement and to provide for an audit to ensure that expenditures conform with the agreement; but neither do they prohibit such an arrangement.

6.219 In recent years, because of the flexibility in interpreting the unconditional nature of grants, the distinction between grants and contributions has all but disappeared. CEIC has adopted different positions on ECGC and LEAD with respect to monitoring and evaluation by its officers of projects funded with grants. For example, for ECGC the Commission had not specified whether the grant agreements should be enforced, whereas enforcement was required for LEAD. We also noted that some LEAD corporations refused to give CEIC access to certain information, claiming that grants were unconditional transfers and include no obligation to account for the use of funds.

6.220 In the case of the ECGC program, the procedure for evaluating the effectiveness of the grants programs in meeting CEIC's objectives was not established.

6.221 In our view, because grants require no monitoring and follow-up, the use of grants should be minimized. Although grants may be less costly to administer, we believe that departments and agencies should be authorized to use this funding mechanism only where it can be demonstrated clearly that this is a more effective way of achieving program objectives. If the department or agency believes some monitoring and follow-up should be imposed, it should use contributions as the funding mechanism. However, the specific procedures required should be tailored to each program.

6.222 Should grants be used, control mechanisms, such as proper eligibility criteria, payment by installments and program evaluation, should be specified.

6.223 **CEIC should minimize the use of grants in funding its job creation programs. Where grants are to be used, CEIC, in collaboration with Treasury Board, should demonstrate that this mechanism is a more effective way of achieving program objectives.**

Commission's response: The choice of grants under the LEAD Program for the purpose of providing investment funds to LEAD Corporations was to establish an arm's-length relationship with ultimate clients.

Although monitoring and audits are not required for grants, these funds have in fact been monitored under the LEAD program, and CEIC is refining and further tightening controls for the use of these funds under Community Futures.

In the case of the ECGC Program, grants were used because the scope and nature of project activity were such that the requirements associated with contributions were seen to be too restrictive from an operational point of view.

With both the LEAD and ECGC programs, the Treasury Board was consulted and approved the use of grant funds.

CEIC agrees with the Report's suggestion that there exists some confusion about the appropriate uses of grants versus contributions as alternative forms of payments.

CEIC will assess the use of grants versus contributions as part of its review of the delivery of the Canadian Jobs Strategy during the latter part of the fiscal year 1986-87. It will carry this out in close consultation with the Office of the Comptroller General and the Treasury Board.

6.224 CEIC should specify the evaluation method to be used to assess the effectiveness of grants programs.

Commission's response: CEIC has an excellent record with respect to evaluations. For some years now, CEIC has had a formal evaluation cycle.

All programs are formally evaluated and, indeed, such an evaluation is already started for the LEAD program.

Unlike programs with more easily measured objectives such as short-term jobs created or training courses completed, LEAD and Community Futures have objectives which require a more in-depth analysis of results and tracking over time to determine the nature and durability of results. The program also aims at more intangible results which can only be assessed by in-depth evaluation designed to make both quantitative and qualitative assessments.

Information for Parliament

6.225 Parliament was not adequately informed about the nature of the ECGC program, about the use of the funds allocated to it, or about its objectives and actual results. The information Parliament received about the results of the LEAD program was not accurate or reliable.

6.226 Under Treasury Board directives, grant recipients or categories of recipients must be specifically authorized by Parliament. In the Main and Supplementary Estimates presented since the inception of the ECGC and LEAD programs, CEIC has not shown the programs' intended classes of recipients in the table of grants. Members therefore did not know – and thus did not approve – the classes of grant recipients under the two programs.

6.227 Part III of its Estimates and CEIC's annual reports contained no detailed descriptions of the ECGC program. There were, however, descriptions of other job creation programs, including LEAD. We observed that all job creation programs are given the same objective in the Estimates; that is, "projects undertaken... for the purpose of providing employment to unemployed workers and contributing to the betterment of the community". This description, which applies to all programs, does not identify the differences – which are sometimes significant – in the objectives, mechanisms and target groups for the various programs.

6.228 Part III of the Estimates and annual reports are expected to contain information about the anticipated and actual performance of programs. In the case of ECGC, we found that these documents said nothing about program results. There was performance information about LEAD, but there were serious gaps in it. Because it had difficulty in collecting and analysing information from the projects, CEIC had to rely on estimates of program results for its presentation to Parliament. In the case of LEAD corporations, some of the information that was available was not reported.

6.229 In setting out the 1984-85 performance of LEAD projects and corporations in Part III of the 1986-87 Estimates, CEIC describes "the creation of 320,021 work-weeks of employment and 7,294 jobs" as "actual performance against plans for 1984-85". The narrative indicates that these figures are "lower than the established goal" even though the figures reported as actual were estimates. As well, the number of jobs and work-weeks do not represent separate achievements; they are two different methods of measuring the same thing. We looked at how CEIC had arrived at the figures stated. In the case of projects, CEIC estimated that 120,521 work-weeks or 3,304 jobs had been created. The number of work-weeks had been based on a sample of signed agreements and assumed that all agreements had created work-weeks in the same proportion as the sample. To convert these work-weeks into jobs, CEIC established that the jobs varied in length according to the program component. However, the Commission has not been able to substantiate these estimates to actual results, either for the number of work-weeks or for job length.

6.230 In the case of corporations, the estimate of 3,900 jobs or 199,500 work-weeks was based on the assumption that the number of jobs created during the year in question was proportional to the number of jobs created in the preceding year and that all the jobs were full-time. CEIC had no idea, however, whether the number of jobs in the preceding year was a reliable basis for the calculation. In making the calculation, CEIC assumed the existence of 85 corporations. A document obtained from the Commission, which stated that the number of jobs had been "carefully tracked", showed, however, that the number of corporations was 37 in 1984-85 and the number of jobs created was 1,094, of which 168 (15 per cent) had subsequently terminated. Net job creation was therefore 926, compared to the estimate of 3,900.

6.231 The primary purpose of LEAD was to create permanent jobs. It is surprising that CEIC did not provide information to Parliament about the permanence of the jobs created, whether by LEAD corporations or by projects. Thus Parliament was not informed about progress toward achieving the main objective of the program.

MINISTRY OF THE SOLICITOR GENERAL

CORRECTIONAL SERVICE OF CANADA

MINISTRY OF THE SOLICITOR GENERAL
CORRECTIONAL SERVICE OF CANADA

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7

MINISTRY OF THE SOLICITOR GENERAL CORRECTIONAL SERVICE OF CANADA

Introduction

7.1 The Correctional Service of Canada (CSC) was established in 1977 under the Penitentiary Act (amended) through a merger of the former Canadian Penitentiary Service and the National Parole Service (then part of the National Parole Board). The Solicitor General is the Minister in charge of the Correctional Service and of the National Parole Board.

7.2 Under the Solicitor General Act, the duties, powers and functions of the Solicitor General extend to and include all matters relating to reformatories, prisons and penitentiaries, parole and remissions, and to the Royal Canadian Mounted Police.

7.3 Under the direction of the Minister, the Commissioner of Corrections is responsible for the control and management of CSC including the custody of inmates and the correctional programs aimed at their satisfactory re-integration into society. The Commissioner's responsibilities relating to parole include making recommendations for granting parole and supervising inmates granted parole or released on mandatory supervision. These latter responsibilities are part of the parole program that CSC shares with the National Parole Board which is a separate judicial entity, independent of CSC.

7.4 The objective of the Correctional Service of Canada as defined in the Estimates is "to administer sentences imposed by the courts and to prepare offenders for their return as useful citizens to the community".

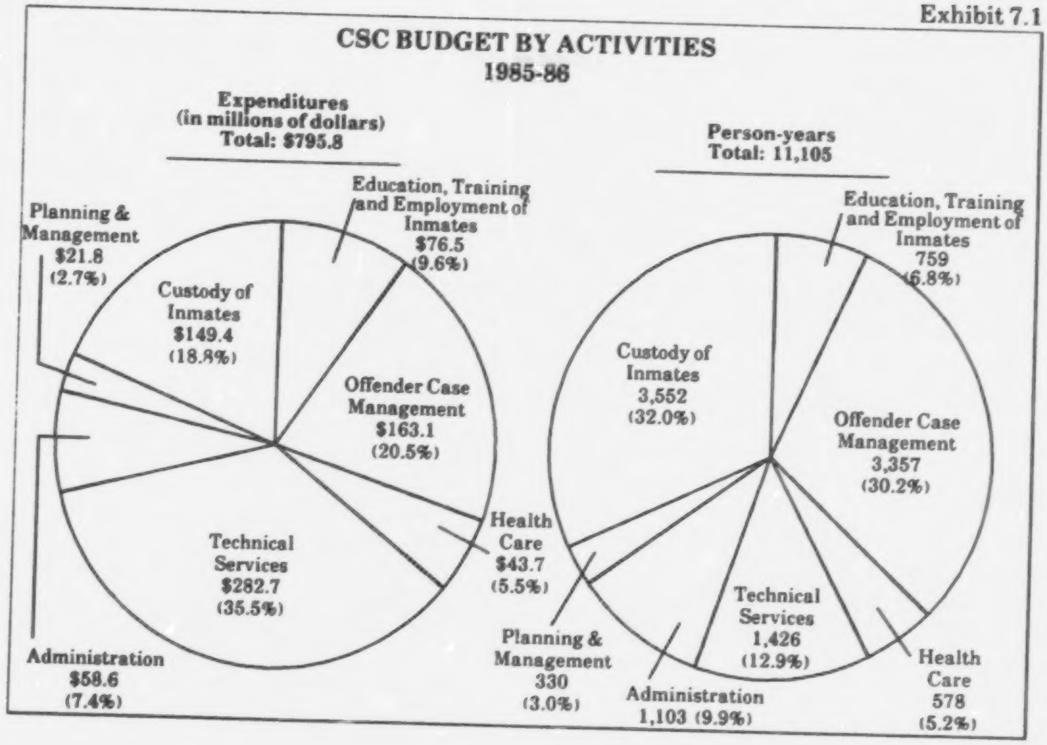
7.5 The 1985-86 Estimates provided for $796 million and 11,105 person-years to achieve this objective. The budget was allocated among seven functional activities of CSC's program, as shown in Exhibit 7.1.

7.6 CSC is organized into a national headquarters in Ottawa, 5 regional headquarters, 42 institutions, 19 community correctional centres, and 61 parole offices.

7.7 CSC is a part of the Canadian criminal justice system. Other elements of the system are criminal law, law enforcement agencies, criminal courts, parole boards and community-run correctional services. Jurisdiction over these components is divided among federal, provincial and municipal governments.

7.8 Under the provisions of the Criminal Code of Canada, persons sentenced to two years or more are imprisoned in a federal penitentiary. Accordingly, CSC's jurisdiction extends only to those offenders that are sentenced to imprisonment of two years or more. Those that receive a prison sentence of less than two years go to a provincial reformatory or jail.

Exhibit 7.1


CSC BUDGET BY ACTIVITIES
1985-86

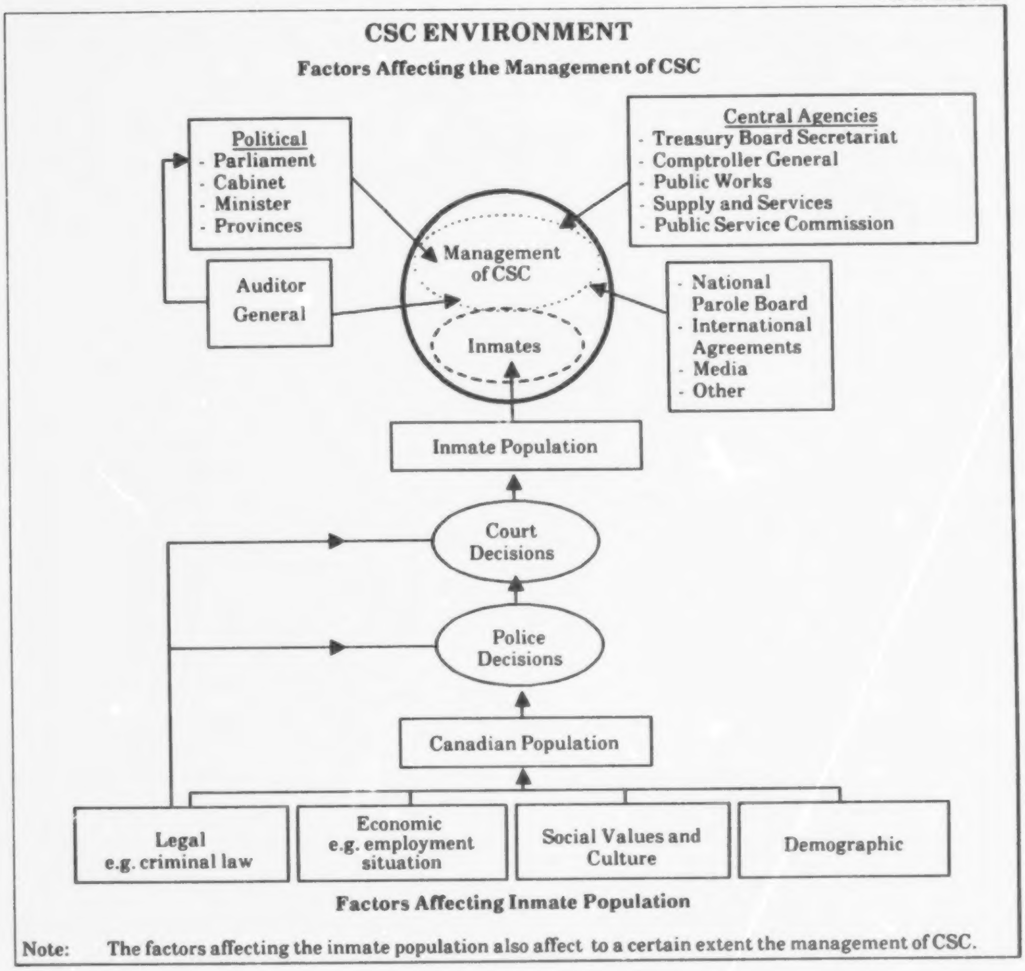
7.9 During 1985-86, CSC had an average of 12,400 inmates registered. In addition, 6,000 people were on parole or under mandatory supervision. Since 1983, the number of inmates has grown at an average rate of 5 per cent a year.

7.10 CSC operates in a complex environment, illustrated in Exhibit 7.2. CSC management must be aware of and respond to this environment.

7.11 Over the last 10 years, CSC has been required to respond to several assessments of its work. One of the most significant of these was the 1976-77 Report of the Parliamentary Sub-committee on the Penitentiary System in Canada (the MacGuigan report). The overall finding of this study was that "a crisis exists in the Canadian penitentiary system. It can be met only by the implementation of large-scale reforms".

7.12 The MacGuigan report set the tone and direction for changes subsequently introduced into the system. In 1981, our first comprehensive audit of CSC also identified the need for improvement in several areas. From 1977 until the mid-1980s, CSC management concentrated on strengthening administrative controls and increasing centralized authority and direction.

Exhibit 7.2


CSC ENVIRONMENT
Factors Affecting the Management of CSC
Political
- Parliament
- Cabinet
- Minister
- Provinces
Central Agencies
- Treasury Board Secretariat
- Comptroller General
- Public Works
- Supply and Services
- Public Service Commission
Auditor General
Management of CSC
Inmates
- National Parole Board
- International Agreements
- Media
- Other
Inmate Population
Court Decisions
Police Decisions
Canadian Population
Legal e.g. criminal law
Economic e.g. employment situation
Social Values and Culture
Demographic
Factors Affecting Inmate Population

Note: The factors affecting the inmate population also affect to a certain extent the management of CSC.

7.13 In November 1984, CSC's Senior Management Committee approved the recommendation of an internal Task Force on the Mission and Organizational Development to adopt the following as the Correctional Service's mission:

> The Correctional Service of Canada, as part of the criminal justice system, contributes to the protection of society by exercising safe, secure and humane control of offenders while helping them become law-abiding citizens.

7.14 The mission statement used the words "law-abiding citizens" instead of "useful citizens to the community". "Useful citizens to the community" had always been used before in departmental Estimates and it continues to be used in the 1986-87 Estimates. The continued use of different terminology could lead to different interpretations of CSC's true objective and therefore to effectiveness measurement problems. CSC has undertaken a review of all its directives, instructions and guidelines to ensure that they are consistent with the mission statement and to reduce their excessive number.

7.15 Also in November 1984, an Advisory Committee (the Carson Committee) appointed by the Solicitor General to advise on the Management of Correctional Institutions, gave its report. The Committee was generally impressed with the advances made by CSC since the MacGuigan report. However, the Committee noted that:

> The very administrative controls and organizational structure which allowed steadfast progress to be made could now be adversely affecting staff morale and jeopardizing the achievement of the dual objectives of humane custody and effective programming.

7.16 The Committee commented on over-centralized authority, over-control, and growth in the size and authority of the functional groups at headquarters compared to institutions. Finally, the Committee warned that "if the Service continues in its centralized management orientation, the quality of relations and involvement between staff and inmates will deteriorate".

7.17 The present Commissioner took office in February 1985, in the wake of the Carson Committee report. In response to the report and the Treasury Board call for restraint on expenditure, the Commissioner initiated 21 organizational and resource management reviews, covering almost all aspects of CSC's operations.

7.18 As a result, significant changes have been made in CSC's organization and personnel to increase regional and institutional autonomy through decentralization and at the same time to reduce costs. For example, CSC has redefined the responsibilities of regions by having them prepare their own regional accommodation plans, correctional officer training has been regionalized, and a moratorium has been placed on all new systems development. In April 1986, Treasury Board approved a plan to modify CSC's organization structure. Further changes are expected as a result of this plan.

7.19 CSC is therefore in a state of flux. The major thrust is toward decentralization. It is too early for us to assess the full impact of the changes. Where possible, we have commented in this chapter on their potential impact. Management expects that once these changes have been completed, things will stabilize and the intended improvements will result. Although we are convinced of management's commitment to make improvements, there is a risk that CSC might move from over-centralization to over-decentralization, resulting in a negative effect on its operational efficiency and program effectiveness. Great care will be needed to maintain a proper balance.

Audit Scope

7.20 Our audit addressed six major activities of the Service (see Exhibit 7.1):

- technical services;
- custody of inmates;
- offender case management;
- education, training and employment of inmates;
- administration; and
- planning and management.

These activities accounted for 94 per cent of the total CSC budget for 1985-86. The remaining 6 per cent of the budget relates to health care.

7.21 Under technical services, we audited planning and construction of inmate accommodation, planning and implementation of a major electronic surveillance system, and materiel management.

7.22 In the area of custody of inmates, we reviewed the benefits received from the electronic surveillance system, the extent of present and projected "double bunking" in correctional institutions and the way CSC is responding to the situation. Double bunking refers to housing two inmates in a cell built to accommodate only one inmate.

7.23 In the offender case management area, our aim was to assess whether satisfactory procedures were in place to measure the effectiveness of the program in meeting the needs of inmates. We also reviewed the inmate grievance system.

7.24 In respect of education, training and employment of inmates, our review was directed mainly at the procedures CSC has to measure the efficiency and effectiveness of the Industries program and the Education and Training program.

7.25 In administration, we covered management of the Correctional Officers (CX) group including control of overtime, management of the financial function, and contracting.

7.26 Under the planning and management activity, we focused on management information systems, internal audit and program evaluation.

7.27 In addition, we reviewed the Parole program to determine the extent to which satisfactory procedures were in place, both in CSC and in the National Parole Board, to measure the performance of the program and the linkages and exchange of information between the Correctional Service and the Parole Board.

7.28 Since this was our second comprehensive audit in CSC, we also carried out a follow-up of the recommendations we made in 1981. Where appropriate, we have commented in this chapter on the progress made by CSC.

7.29 Our audit included interviews and a review of documentation at national headquarters, regional headquarters, institutions and parole offices. Our field work was concentrated in the Ontario, Quebec and Prairie regions which accounted for 73 per cent of total regional operating expenditures during 1985-86.

Inmate Accommodation

7.30 CSC is required to provide accommodation for its inmates in order to carry out two of its fundamental functions – custody of the inmates and delivery of correctional programs. These two functions flow directly from CSC's objective of administering sentences imposed by the courts and preparing offenders for their return to the community as useful/law-abiding citizens.

7.31 Inmates need different kinds of accommodation. In view of this, CSC has classified its institutions into six general levels – S-1 to S-6, in ascending order of security requirements – and three special categories, Special Handling Unit, Protective Custody, and Psychiatric. The S-1 and S-2 classifications are designated as minimum security, S-3, S-4 and S-5 as medium security, and S-6 as maximum security. Special Handling Units are super-maximum security accommodation and are also known as S-7. The Protective Custody Units provide multi-level security accommodation but are built to the security specifications of the highest level of inmates to be accommodated, so far S-6. The Psychiatric Units house inmates assessed as requiring treatment for mental or emotional disorders. In addition, CSC maintains reception centres at the S-6 level to accommodate new inmates pending their placement in the appropriate institutions.

7.32 We reviewed CSC's policy, processes and practices relating to planning and constructing inmate accommodation. The purpose of our review was to determine whether the policy, processes and practices have been consistent with program needs, have reflected due regard for economy and efficiency, and have complied with Treasury Board's policy on major capital projects. In addition, our aim was to determine whether the information supplied by CSC to Treasury Board and Parliament has been accurate and sufficient to enable them to make informed assessments and decisions.

7.33 To achieve these objectives, we reviewed CSC's policy and planning process and its management of three major capital projects relating to inmate accommodation.

Accommodation Policy

7.34 Until 1985, CSC policy had been to accommodate the general population of inmates – those classified in S-1 to S-6 security levels – in the regions where they were sentenced or where they wished to reside upon release, and the special population – those classified in Special Handling, Protective Custody and Psychiatric Units – on a national basis, except French-speaking Quebeckers who were all accommodated on a regional basis. The rationale for this policy was that, although it was humane to keep most inmates close to their homes, it was not cost-effective to keep the special category inmates on a regional basis, in view of their small numbers.

7.35 We were told by CSC officials that this policy was changed in 1985. The revised policy requires the Protective Custody and Psychiatric categories also to be accommodated on a regional basis. This policy is not documented, nor is there any analysis to show how cost-effective it would be. The Corporate Policy and Planning Branch told us that it was currently working on a revised set of principles and guidelines for accommodation planning.

7.36 In the absence of a clearly documented policy on accommodating inmates, which can be shown to be cost-effective, there is a risk of unnecessary and expensive construction. CSC has told us that, effective February 1986, no new construction projects would be undertaken until a revised accommodation policy has been defined. According to CSC, the decision to place this moratorium on construction was influenced, among other factors, by the current government restraint on expenditure, the Carson Committee report, and the Nielsen Task Force exercise.

7.37 **The Correctional Service of Canada should document its accommodation policy to guide accommodation planning. Before doing so, CSC should carry out an analysis of the cost-effectiveness of the policy.**

> CSC's response: *The auditors correctly point out that the Corporate Policy and Planning Branch of CSC is presently working on a revised set of principles and guidelines for accommodation planning. This initiative considers the impact of the Carson report and the accommodation-related conclusions of the Deputy Prime Minister's Task Force on Program Review which have had a major influence on our accommodation policy. In view of the above, and the Government's call for restraint, CSC had placed a moratorium on new accommodation projects until a revised accommodation policy is defined. An analysis of the cost-effectiveness of this revised policy will be carried out as recommended by the auditors.*

Accommodation Planning

7.38 Until 1984, CSC was maintaining and annually updating a long-range accommodation plan over a 10-year horizon. The 1984 plan, done in March 1984, provided for a planned net increase in capacity of 4,700 cells by 1992-93, at a total cost of $650 million. In September 1985, in response to Treasury Board's call for restraint on expenditures, CSC carried out a review of its long-range plan and reduced the planned increase to 2,480 cells. In February 1986, CSC cancelled all building projects except those already under way. As a result, CSC is currently carrying on five projects. They will increase the cell capacity by 1,000, at a total cost of $200 million. Three of these projects - Atlantic Institution, Donnacona, and Port Cartier - are constructions of new institutions at Protective Custody and maximum security levels, for a total cell capacity of 868. The remaining two, involving a cell capacity of 132, are expansions of medium security institutions in Bowden, Alberta, and Mission, British Columbia.

7.39 **Planning process.** Until the re-organization of national headquarters effective April 1986, the Technical Services Branch was responsible for co-ordinating and annually updating the long-range accommodation plan. The updates were made on the basis of the forecasts of inmate population prepared by the Corporate Policy and Planning Branch, changes in policies and operational requirements, and a Technical Services Branch analysis of the available options.

7.40 This process was appropriate to the extent that it was designed to ensure that the plans were consistent with program needs, that they were made with due regard to economy and efficiency and were consistent with the Treasury Board policy for planning major capital projects. However, we identified some problems with the application of this process.

7.41 The first related to the data base used for preparing the inmate population forecasts. One of the inputs to the forecasting system is the current number of inmates classified at each security level in each region. A CSC Task Force on Inmate Population Forecasting reported in January 1986 that the classification of inmates is not always up to date. An error in this input to the forecasting system can diminish the reliability of the forecasts. We noted, however, that during the past three years, the actual number of inmates was within 9 per cent of the forecasts at various levels. The Task Force has recommended that "the inmate security field be updated on a regular basis".

7.42 The second problem was that, in some cases, such as the proposed replacement of Laval institution by Donnacona (for maximum security capacity) and by Drummond 2 (for Protective Custody capacity) in the Quebec region, alternatives were considered only on the basis of initial capital costs rather than the full life-cycle costs. A similar deficiency was identified in our previous comprehensive audit (paragraph 9.75, 1981 Report).

7.43 During our discussions, CSC officials informed us that since 1983, they have generally been taking into account the full life-cycle costs of alternatives in their analyses of options.

7.44 The third problem related to the responsibilities for preparing and co-ordinating the accommodation plans. In 1985, an internal Task Force on Review of Capital reported that:

> The process is not well understood throughout CSC. There are frequent disputes between national headquarters Branch Heads, Technical Services, regional headquarters, and institutions about their responsibilities, and there is no effective conflict resolution process.

7.45 To resolve this problem, CSC has redefined the responsibilities, giving more autonomy to the regions to determine their own regional plans. Although the new arrangements are intended to be an improvement in that they move authority closer to where the accommodation is needed, they do not specifically provide for effective co-ordination and monitoring at national headquarters. As a result, there is a risk that regional plans will take into account surpluses or shortages of capacity at various security levels on a regional basis only.

7.46 The fourth problem, also identified by the Task Force on Review of Capital, was that the long-range accommodation plan was changed every year on the basis of annual short-term fluctuations in the forecasts of inmate population, resulting in unnecessary changes and delays. To resolve this problem, CSC has decided to change the plan only once in every three years on the basis of long-term trends.

7.47 We concur with the decision to change the plan only on the basis of long-term trends. But we believe that, while the core elements of the plan should not be changed more frequently than every three years, an annual review of the plan is necessary to provide for timely adjustments for significant unforeseen developments. Otherwise, after three years, it might be too late to make such adjustments.

7.48 **The Correctional Service's national headquarters should monitor and co-ordinate regional accommodation plans.**

> *CSC's response: In redefining responsibilities and providing more autonomy to the regions in determining their own accommodation plans, CSC recognizes that it must provide for effective co-ordination and monitoring at national headquarters. This is reflected in the context of the new organization.*

7.49 **The Correctional Service of Canada should review its long-range accommodation plan annually to make adjustments for significant unforeseen developments.**

> *CSC's response: A Service Task Force on Review of Capital studied the problem and concluded that the most cost-effective approach to accommodation planning is to use the long-term trend for long-term planning. CSC intends to continue its practice of updating and adjusting its Accommodation Plan for significant, unforeseen developments through annual reviews.*

7.50 **Plans.** We compared the existing and under-construction capacity as of 30 April 1986 with the latest forecasts of inmate population for 1992-93, and found that there was significant imbalance in the capacity and the forecasts at the maximum and medium security levels. This is demonstrated by the following table which also includes Protective Custody, since accommodation at this level has so far been built to maximum security specifications.

	Capacity vs Forecast		
Security Level	Forecast of inmate population 1992-93	Capacity, existing and under-construction 30 April 1986	Surplus (Shortage)
Protective Custody	1,332	1,378[1]	46
Maximum (S-6)	1,709	2,368[1]	659
Medium (S-3, S-4, S-5)	7,020	5,542	(1,478)

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[1] Excludes Laval institution in Quebec which CSC has planned to close. Laval has a capacity of 188 at Protective Custody and 415 at maximum security level – total 603 cells.

7.51 A breakdown of the excess and shortage by regions, as shown in the following table, indicates that the excess at the Protective Custody and maximum security levels will be mainly in eastern regions of Canada, with some shortage in the western regions. The shortage at medium security levels will exist in all regions.

Capacity[1] vs Forecast[2]

Security Level	Excess/(Shortage)					
	Pacific	**Prairie**	**Ontario**	**Quebec**	**Atlantic**	**Total Canada**
Protective Custody	(157)	(13)	44	30[3]	142	**46[3]**
Maximum (S-6)	16	(79)	80	381[4]	261	**659[4]**
Medium (S-3, S-4, S-5)	(160)	(394)	(221)	(486)	(217)	**(1,478)**

[1] Represents existing and under-construction cell capacity as of 30 April 1986.

[2] Represents forecast of inmate population for 1992-93, prepared by the Corporate Policy and Planning Branch of CSC in September 1984.

[3] Excludes Laval (Protective Custody capacity 188).

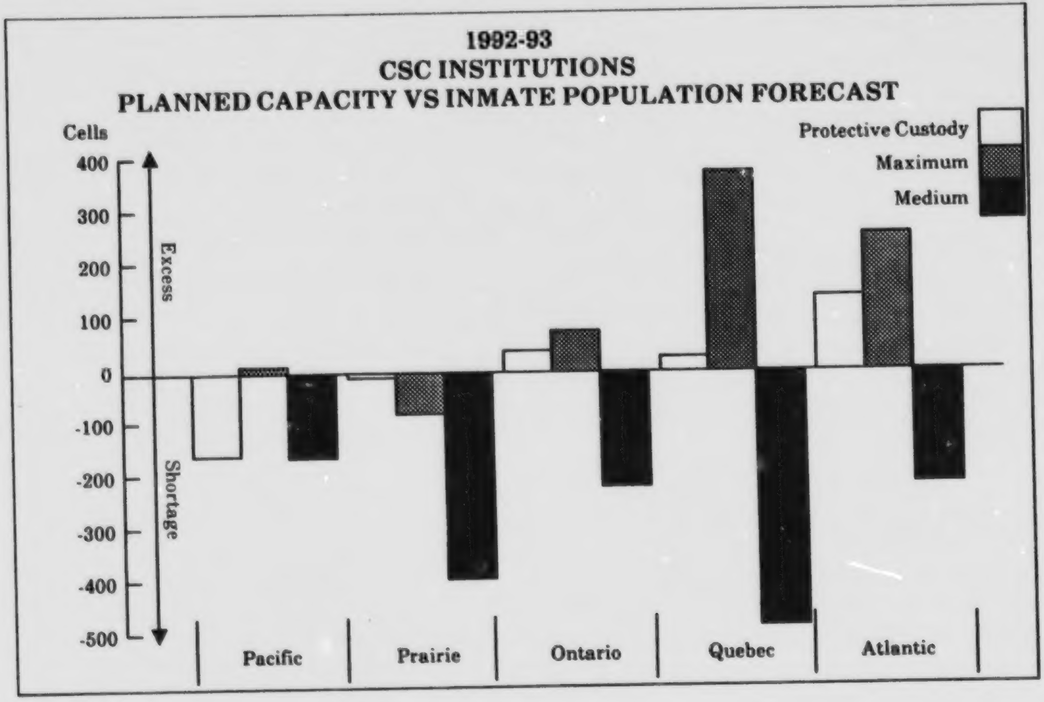
[4] Includes Drummond 1 (capacity 252), built as S-6 but used as S-4.
Excludes Laval (maximum security capacity 415).

7.52 It should be noted that we have excluded Laval from the capacity at Protective Custody and maximum security levels, because CSC has told us that it plans to close Laval. In the past, however, CSC has planned several closures that never took place, including Laval. The excess capacity shown in the foregoing table is therefore conservative. If Laval is not closed, the excess capacity at the Protective Custody level will rise to 218 in Quebec region and to 234 in Canada. At the maximum security level, it will rise to 796 in Quebec and to 1,074 in Canada. The information in the foregoing table is illustrated in Exhibit 7.3.

7.53 The excess capacity at the Protective Custody and maximum security levels is mainly attributable to three reasons.

7.54 First, new institutions at Protective Custody and maximum security levels were initially planned either to replace older institutions or to provide for additional capacity in view of a forecast increase in inmate population. Later, CSC's thinking changed, and it decided to renovate and retain the older institutions as well – Dorchester, Archambault, Laval, and Kingston Penitentiary, resulting in a surplus in the planned capacity. We were told by CSC that there were various reasons for the change in thinking, such as major short-term fluctuations in the inmate population forecasts, changes in policies and representations from local communities.

Exhibit 7.3



7.55 Second, CSC policy has been that, even though a Protective Custody institution is generally built to the same security specification as a maximum security (S-6) institution, Protective Custody and maximum security inmates should not be put in the same institution. Consequently, even where there was surplus capacity in a maximum security institution, it was not used to accommodate Protective Custody inmates; separate institutions were built for them.

7.56 Although we realize that Protective Custody inmates, by their very nature, should not be mixed with the general population of inmates, we think that, where significant surplus capacity exists at the maximum security level, it might be more cost-effective to convert this surplus capacity into a separate unit for Protective Custody inmates instead of building a new institution for them. For example, in the case of Drummond 1 which had been built to maximum security specification but was no longer required at that level, it would have been more economical to convert it into a Protective Custody institution instead of building a new one at Port Cartier. We understand that CSC is currently reassessing its accommodation policy relating to Protective Custody.

7.57 Third – and a dominant reason – is that the decisions have been influenced not only by program needs but also by other considerations such as providing economic benefits to depressed areas. It should be noted that the Carson Committee also realized that CSC has been required to build for non-program-related reasons. The Committee observed that:

> Historically, correctional institutions in Canada have been located, constructed and operated more out of a need for regional economic development than for a concern over the best fit into the program needs of the system.
>
> The basic functions of the Service are to provide suitable custody and programming. This should be accomplished within the context of regional cultures and the maintenance of familial and other community relationships.

7.58 We further noted that where CSC was required to build at security levels and places not justified by program needs, for purposes outside its stated objective, it did not identify and disclose to Parliament the additional cost of meeting those purposes. Furthermore, in some cases, the information provided to Treasury Board for obtaining approval to the proposed construction was not up to date. Thus the information provided to Treasury Board and Parliament was not sufficient to enable them to make informed decisions and assessments.

7.59 The cases in point are those of the construction of a Protective Custody institution at Renous, New Brunswick (the Atlantic Institution, capacity 250); a maximum security institution at Drummondville, Quebec (namely Drummond 1, capacity 252); and a Protective Custody institution at Port Cartier, Quebec (capacity 250). These institutions are the subject of the first three case studies starting at paragraph 7.70.

7.60 The shortage at the medium security level is mainly due to the fact that most of the planned capacity cancelled in 1985 and 1986 was at the medium security level. CSC plans to make up for part of the shortage at the medium security level by other means, such as using exchange of service agreements with the provinces and temporary accommodation. So far, the exchange of service agreements provide for a total capacity of 545 cells by 1988-89. Of these, only 360 relate to the medium security level compared to the projected 1992-93 shortage of 1,478 cells at that level.

7.61 We also realize that CSC has recently (in June 1986) decided to replace the S-1 to S-7 levels by a four-level classification – minimum, medium, maximum, and special handling. In our opinion, this will not significantly alter the existing imbalance in the capacity and the inmate population forecasts.

7.62 It should be noted that the 1984 and earlier long-range accommodation plans always aimed to balance the capacity with the forecast requirements. However, the factors discussed previously have contributed to the imbalance.

7.63 **Effects.** The decisions to construct the new institutions at Renous, Drummondville and Port Cartier have had three significant effects.

7.64 First, based on our most conservative estimate, CSC has committed itself to an extra capital cost of $27 million (see table following) and an extra operating cost of $30 million present value over the life cycle of Port Cartier (see paragraph 7.96).

Extra Capital Cost of Building at Protective Custody and Maximum Security Levels

Institution	Type and Capacity	Extra Cost (millions of dollars) Capital $
Atlantic	PC, 250	8
Drummond 1	S-6, 252	8
Port Cartier	PC, 250	11
Total		27

7.65 Second, CSC is likely to have increased vacancies in eastern regions and increased double bunking in western regions at the Protective Custody and maximum security levels. At the medium security level, CSC is likely to have increased double bunking in all regions. As mentioned in paragraph 7.109, CSC is monitoring the double bunking situation in the institutions and has identified a number of solutions to alleviate the problem.

7.66 Third, there could be an adverse effect on the achievement of CSC's program objective of preparing inmates for their return as useful/law-abiding citizens to the community.

7.67 **The Correctional Service of Canada should review its accommodation plans to ensure that the planned capacity matches the inmate population forecast by security levels and regions in accordance with its accommodation policy.**

> CSC's response: *At the time of the audit, CSC was already reviewing its accommodation plans. This need for review was initiated for a number of reasons such as the findings and recommendations of the Carson Report and the Deputy Prime Minister's Task Force Study as well as Treasury Board's program on restraint. It was felt that the accommodation policy had to be revisited and, as a result, CSC placed a moratorium on all new construction except for those already under way. It became evident that with the suggested changes in policy direction, we would have excess maximum capacity with the new institutions coming on stream. The auditors accurately point out that part of this imbalance was created by a policy decision of accommodating, as much as possible, inmates in their respective regions/community. The auditors also mention that CSC had planned several closures which to date have not taken place. However, with the moratorium on construction, it was felt that CSC should consider renovating some of the older institutions with the intent possibly of using some at lower levels of security, thus partially rectifying the imbalance. That, in addition to the efforts expended to maximize use of provincial cells and to develop sentence management alternatives, should go a long way to balance capacity with forecast of inmate population.*

7.68 If the Service is required to incur expenditures to meet objectives that are outside its stated objective, it should identify the additional cost involved and disclose it to the authority approving the expenditures and subsequently to Parliament.

7.69 In considering the replacement of one project with another, the Correctional Service of Canada should reassess its need for the project in the light of the latest available information and disclose the information to Treasury Board, or other authority competent to approve the change.

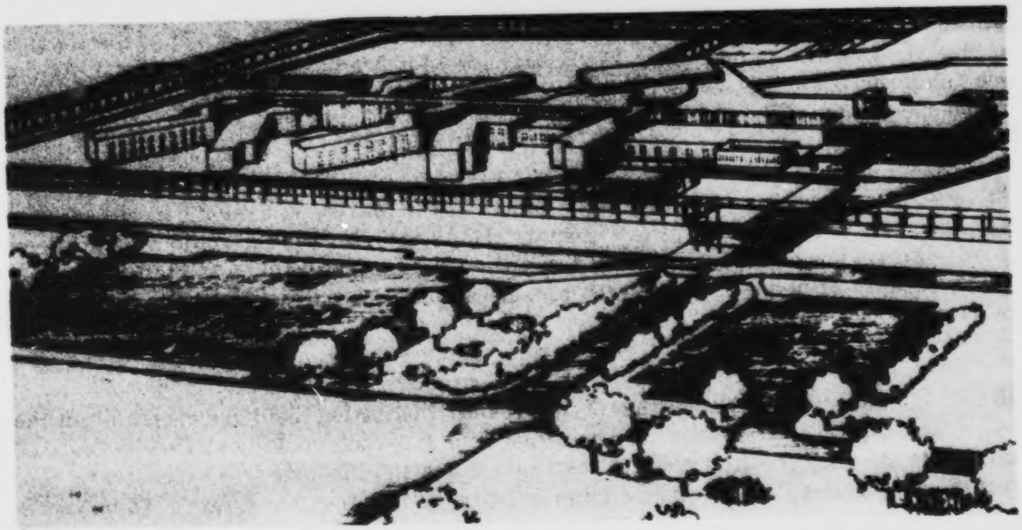
CSC's response: CSC generally agrees with the thrust of these recommendations and will attempt to be more precise in the future. However, the Service believed at that time that adequate information was available and/or provided.

In general, CSC has identified and obtained Treasury Board support for the subject changes through annual Accommodation Plan submissions, bi-annual updates to the Operational Plan, and Treasury Board submissions for the specific projects.

The rationale for revising the security level at Drummond Institution was primarily the result of changing inmate population requirements and distributions. It appears as if the observation is based solely on the fact that the official project title, as contained in the "Blue Book", was never officially changed from "Drummondville Medium Security Institution".

Similarly, the need to retain Kingston Penitentiary is directly linked to increasing Protective Custody requirements following 1982. It must be conceded that little economic analysis went into either the initial decision to close the institution or the subsequent decision to retain it, as the former was primarily operationally and economically based, while the latter was requirements driven. When the forecasts went up, the "retain KP" option was used because it was easy to discontinue if and when the forecasts went down.

Case Study 1 - Atlantic Institution, Renous, New Brunswick



Atlantic Institution, Renous, New Brunswick (artist's concept). Protective Custody. Capacity: 250 cells. Estimated completion year: 1986. Estimated cost: $61.5 million. Capital cost of institution per cell: $246,000 (see paragraph 7.70).

7.70 In 1978, CSC planned to build a maximum security institution at Renous, New Brunswick, with a capacity of 204 cells. Its purpose was to provide for partial replacement of the Dorchester facility, also in New Brunswick.

7.71 In March 1980, CSC decided to renovate and retain Dorchester as a maximum security institution, informing Treasury Board that no new maximum security capacity was required in the Atlantic region. Consequently, CSC proposed to cancel the Renous project.

7.72 In April 1980, Treasury Board "requested that further study be done before a final decision is reached on the proposal to cancel".

7.73 In April 1981, as a result of such further study, CSC changed its recommendation to Treasury Board and proposed to build at Renous again, but this time as a national Protective Custody/Special Handling institution with a capacity of 250 and 100 respectively. The purpose of the Protective Custody Unit was to replace part of Kingston Penitentiary, which had a Protective Custody capacity of 379 at that time. Kingston Penitentiary was to be closed.

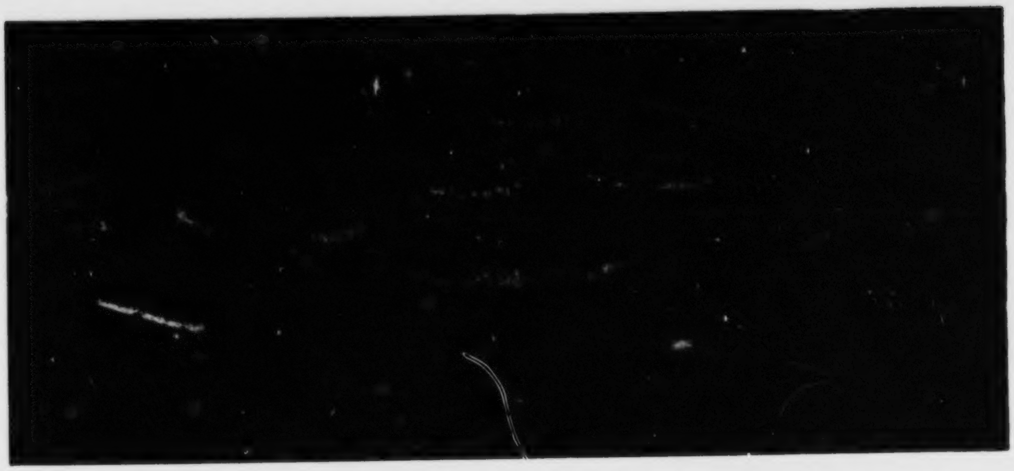
7.74 In 1983, because of an increase in the forecast for Protective Custody population, CSC decided to retain Kingston Penitentiary at a reduced Protective Custody capacity of 296, in addition to the Atlantic Institution. At that time, CSC had a total Protective Custody capacity of 802 cells in English-speaking regions (Kingston: 372; Saskatchewan: 430) against the latest forecast of 1,035 Protective Custody inmates for 1991-92. Thus there was a shortage of 233 cells at the Protective Custody level for English-speaking regions. At the same time, there was a surplus capacity of 419 cells at the maximum security level, in English-speaking regions.

7.75 If part of the surplus capacity of 419 at the maximum security level had been used to provide for Protective Custody inmates, the Atlantic Institution would not have been needed. Our review of the files indicated that the Atlantic Institution was built anyway at Renous, because of non-program-related considerations such as providing employment to local people.

7.76 If a capacity equal to that of the Atlantic Institution (250) had been built at the medium security level where the need existed, the capital cost would have been at least $8 million less, because medium security institutions are significantly less expensive to construct than Protective Custody or maximum security institutions. The figure of $8 million is arrived at by multiplying 250 by $32,000 – our most conservative estimate of the capital cost differential per cell between a Protective Custody/maximum security and a medium security institution.

7.77 The Special Handling Unit of the Atlantic Institution was cancelled in 1985 due to a change in the forecast of inmates requiring special handling. As a result of the late decision to cancel the Special Handling Unit, CSC did not receive value for money due to sunk costs of approximately $10 million (see paragraph 7.132).

Case Study 2 - Drummond 1 Institution, Drummondville, Quebec



Drummond 1 Institution, Drummondville, Quebec. Built in 1984 as maximum security, used as medium security. Capacity: 252 cells. Cost: $40.5 million. Capital cost of institution per cell: $161,000 (see paragraph 7.78).

7.78 In February 1979, Treasury Board approved a CSC proposal to construct a medium security institution with a cell capacity of 210 at Drummondville, Quebec – Drummond 1. This proposal was justified on the basis of the forecasts of inmate population available to CSC at that time.

7.79 In March 1980, CSC revised its plans and recommended that Drummond 1 be built as a maximum security dedicated Protective Custody institution. CSC justified this proposal mainly on the grounds that the new institution would replace the Protective Custody Unit (188 cells) of the Laval institution in the Quebec region. Laval was proposed to be phased out. Treasury Board approved the proposal in April 1980. The 1981 and 1982 accommodation plans confirmed the planned construction of Drummond 1 as a Protective Custody institution. Construction of the institution was started in early 1982.

7.80 In March 1983, CSC proposed the construction of another Protective Custody institution at Drummondville, Quebec with a cell capacity of 240 – Drummond 2. Drummond 1 was designated as a general population maximum security institution and its construction continued on the grounds that Archambault, an older maximum security institution with a capacity of 429 inmates, would be downgraded to a medium security level, and Drummond 1, together with another new institution – Donnacona, would meet the maximum security needs in the Quebec region. At that time, the latest available forecast (December 1982) showed the expected inmate population at the S-6 level for the Quebec region at the end of the 10-year horizon – 1990-91 as 682. Compared to that, the planned capacity was 732 (Donnacona: 480; and Drummond 1 : 252).

7.81 In September 1983, the forecast for maximum security inmates in the Quebec region at the end of the 10-year horizon, rose to 831 from 682 in the previous year. Consequently, CSC decided to retain Archambault as a maximum security institution. This made it unnecessary to build Drummond 1 at the maximum security level, and CSC decided to change it to a medium security institution. Another reason given for this change was that the local community had opposed the use of Drummond 1 as a maximum security institution. However, Drummond 1 was continued to be built at the maximum security level and was completed in March 1984.

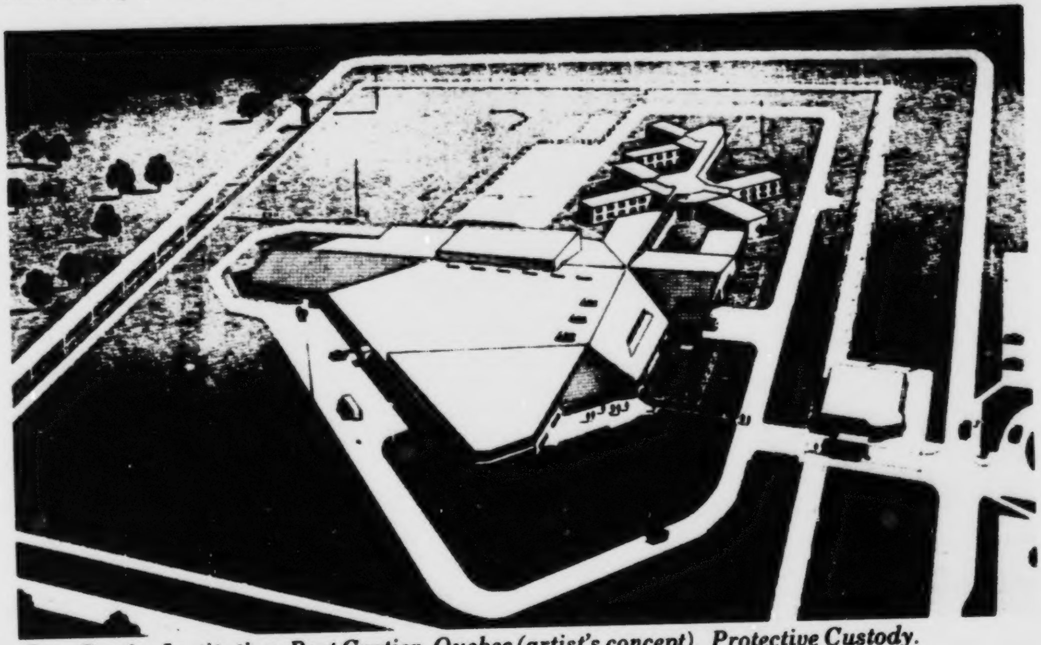
7.82 CSC informed us that one reason for continuing to build Drummond 1 as an S-6 facility was that it was too late to change the design. A change in September 1983 would have delayed the construction with little saving in cost. Another reason was to have more flexibility – a higher security level institution can be used as a lower security facility, but the converse is not true.

7.83 In October 1984, the forecast for S-6 population in the Quebec region came down to 668 from 831 in the previous year. Compared to this, the revised planned capacity in the Quebec region now totals 1049 (Archambault: 429, Donnacona reduced from 480 to 368, and Drummond 1: 252). This exceeds the latest forecast for 1992-93 (668) by 381.

7.84 We believe that, based on the forecast, the excess capacity built at the maximum security level as a result of Drummond 1 is unlikely to be required at that level in CSC's planning horizon.

7.85 If a capacity equal to Drummond 1 (252) had been built at the medium security level where the need existed, the capital cost would have been lower by at least $8 million.

Case Study 3 - Port Cartier Institution, Port Cartier, Quebec



Port Cartier Institution, Port Cartier, Quebec (artist's concept). Protective Custody. Capacity: 250 cells. Estimated completion year: 1988. Estimated cost: $68.1 million. Capital cost of institution per cell: $272,000 (see paragraph 7.86).

7.86 The decision to build a Protective Custody institution at Port Cartier, with a cell capacity of 250, was made in 1985, replacing an earlier decision to build a similar institution at Drummondville, Quebec, Drummond 2.

7.87 Drummond 2 was planned in 1983 for a 240 cell capacity on the grounds that it would replace the Protective Custody unit in Laval, which had a capacity of 188. The plan was to close Laval.

7.88 First, it is not evident to us that the decision to close Laval and to build a new Protective Custody institution to replace Laval's Protective Custody unit was made with due regard to economy. A report from the Department of Public Works in 1983 indicated that Laval was structurally sound and could be kept up with some renovation. Another report from an independent consultant employed by CSC also indicated in 1983 that the renovation would cost $30 million (compared to an estimated cost of $50 million to build a new Protective Custody institution). We have estimated after taking into consideration the life-cycle costs of the alternatives, that it would be $10 million cheaper to renovate and retain Laval as a maximum security institution than to build a new one to replace it. CSC's view is that Laval is old and operationally unsuitable. Cost-benefit considerations form only part of the basis for such decisions.

7.89 Second, even if the initial decision in 1983 to build a Protective Custody institution at Drummondville (Drummond 2) were considered to be justified, the decision in 1985 to build the institution at Port Cartier instead of at Drummondville cannot be justified on the basis of need. By then, conditions had changed, mainly because CSC had decided to retain Archambault (previously planned to be downgraded to a medium security institution) as a maximum security institution. Consequently, as shown in the following table, unlike 1983, there was enough surplus capacity at the maximum security level in 1985 (even excluding Laval) to meet the requirement at the Protective Custody level in the Quebec region.

Capacity vs Forecast – Maximum Security Level
Quebec Region

Year	Capacity planned and under construction	Latest inmate population forecast available at the time	Surplus
1983	732	682[1]	50
(Drummond 1: 252; Donnacona: 480)			
1985	1049	668[2]	381
(Drummond 1: 252; Donnacona: 368[3]; Archambault: 429)			

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[1] Forecast of inmate population in 1991-92 per 1982 forecast used for 1983 long-range accommodation plan.

[2] Forecast of inmate population in 1992-93 per 1984 forecast.

[3] Donnacona's capacity was initially planned at 480 cells to make up for downgrading Archambault. But later, when it was decided to retain Archambault as an S-6 facility, Donnacona's capacity was reduced to 368 cells.

7.90 Our review of the related files indicated that the building of an institution at Port Cartier was based on non-program-related considerations such as providing economic benefits to a depressed area. We asked, if CSC had to build at Port Cartier, why it was building at the Protective Custody level. We were given two reasons.

7.91 First, Port Cartier, being a remote area, is not suitable for a general population of inmates that should be kept close to their families, according to CSC policy. CSC felt that a Protective Custody institution was the only one feasible.

7.92 Second, CSC was given a deadline to complete the institution by the fall of 1988. The most practical way to meet this deadline was to use the blueprints for Donnacona, a maximum security institution already under construction in the Quebec region.

7.93 From a program effectiveness point of view, the decision to locate the institution in such a remote area as Port Cartier has been the subject of much criticism on the part of the Canadian Criminal Justice Association, criminologists, social workers and others. Their view is that the location is likely to have an adverse impact on the achievement of

CSC's objective of preparing inmates for their return as useful/law-abiding citizens to the community. We have been advised by CSC officials that they do not share this point of view.

7.94 A more economical alternative would have been to use Drummond 1 as a Protective Custody institution, because it was already built as an S-6 facility but no longer required at that level. We estimate that by building a Protective Custody institution at Port Cartier, CSC incurred an extra capital cost of at least $11 million compared to converting Drummond 1 to a Protective Custody institution and building a medium security institution to meet the need at that level. Part of this excess cost is due to the use of Donnacona institution blueprints to meet the completion deadline of 1988. The Donnacona institution was built to a larger capacity (368) – 47 per cent higher than the capacity of the Port Cartier institution (250). Thus, the Port Cartier institution will be using the infrastructure and core facilities (such as plumbing, sewerage, electrical and kitchen facilities) designed for a larger facility.

7.95 Another consequence of the 1988 deadline was that in order to meet the deadline, CSC had to use shortcuts to its normal contracting procedures. For example, it entered into sole source contracts for project management and for the preparation of preliminary site plans.

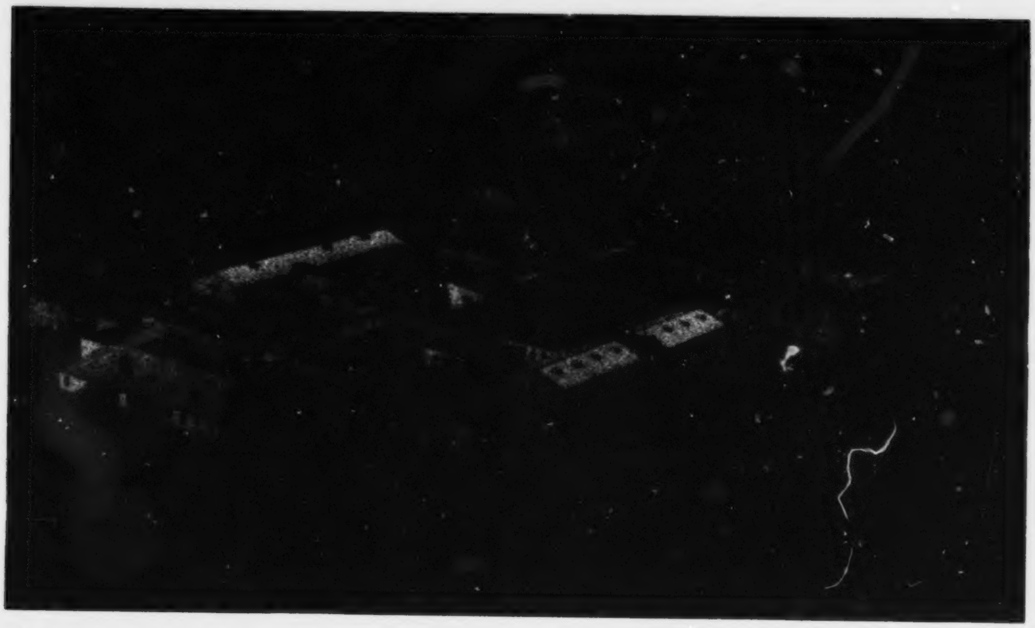
7.96 We also noted that by building the Protective Custody institution at Port Cartier, both construction costs and operating costs increased. At Drummondville, the annual operating cost had been estimated at $9 million; the estimate was $12 million at Port Cartier. The $3 million difference was due to savings obtainable at Drummondville by sharing facilities with Drummond 1. The present value of the excess operating cost of $3 million a year, capitalized over the life cycle of the Port Cartier institution and discounted at 10 per cent, works out to $30 million.

7.97 We conclude, therefore, that in the larger national interest of providing economic benefits to a depressed area, CSC was required to build an institution at a security level higher than the one at which the need existed and at an extra capital cost of at least $11 million. The extra operating cost was $30 million over the life-cycle of the Port Cartier institution.

7.98 In the initial submission to Treasury Board in June 1985 to obtain approval for the Port Cartier project, CSC indicated that the project was simply a replacement for the Drummondville expansion (Drummond 2) already approved by the Board. We think that, since the available surplus capacity at the maximum security level in the Quebec region had changed from 50, when Drummond 2 was approved, to 381 when it was proposed to be replaced by Port Cartier, the Board should have been informed of the change (see paragraph 7.89). This would have made Treasury Board aware of the possibility of using the surplus capacity at maximum security level to meet the Protective Custody requirement. Furthermore, the submission did not indicate the rationale for changing the location.

7.99 We conclude, therefore, that the information provided to Treasury Board was not complete or up to date enough to enable Treasury Board to make an informed decision, paying due regard to program needs and to economy.

Case Study 4 - Correctional Development Centre, Laval, Quebec



Correctional Development Centre, Laval, Quebec. Built as a super-maximum security institution in 1967. Closed in 1984. Capacity: 160 cells. Cost: $6 million. Capital cost of institution per cell: $37,500 (see paragraph 7.100).

7.100 Another example of an institution built at a security level higher than that at which it was subsequently used is the Correctional Development Centre (CDC) in Laval, Quebec.

7.101 The CDC was completed in 1967 at an initial capital cost of $6 million. It was originally designated as a super-maximum security institution with a capacity of 160 cells. Throughout its 20 year history, the CDC has been alternately opened and closed and its basic function changed a number of times. One of these functions was to use it in 1975 as a Community Correctional Centre institution (S-1) although it had been built to the super-maximum (S-7) level. Since 1967, modifications costing approximately $4 million have been made and until early 1986, an additional $6 million of renovations were planned to convert the institution into a minimum security institution at the S-2 level. These latest renovation plans were shelved in February 1986 as part of the CSC decision to cancel all major construction projects except those already under way.

7.102 In December 1984, CSC opened an 80 cell Special Handling Unit at the Quebec Regional Reception Centre in Sainte-Anne-des-Plaines, Quebec, at a cost of $13 million, and the CDC was closed. The CDC remains closed to this day with plans to convert it to a minimum security institution having been abandoned, at least for the immediate future.

7.103 As a result, CSC has an institution that is closed less than 20 years after being opened, on which it has expended to date approximately $10 million in capital cost and has recently spent another $13 million to construct a similar institution in the same general location to replace the first one.

Double Bunking of Inmates

7.104 CSC has been double bunking its inmates to overcome temporary shortages of accommodation at various security levels in its institutions. In February 1986, 780 inmates were double bunked, constituting approximately 7 per cent of the total inmate population. In 1985-86, in response to Treasury Board's call for expenditure restraint, CSC carried out a major review of its accommodation plan and reduced significantly its major construction projects. As a result, there is going to be a significant shortage of accommodation at the maximum security level in the western regions and at the medium security level in all regions. According to the 1986-87 Estimates, Part III, the percentage of CSC inmates double bunked is expected to increase from 7 per cent in 1985-86 to 27 per cent in 1993-94.

7.105 According to the Canadian Criminal Justice Association Standards and the United Nations Standard Minimum Rules for the Treatment of Prisoners, there should be one cell for one prisoner. CSC agrees with these standards. However, it considers them as guidelines, not as mandatory.

7.106 We reviewed the current and projected double bunking in CSC institutions to determine whether it is of a level that is perceived by CSC personnel to be risky and, if so, whether CSC management is adequately responding to the situation.

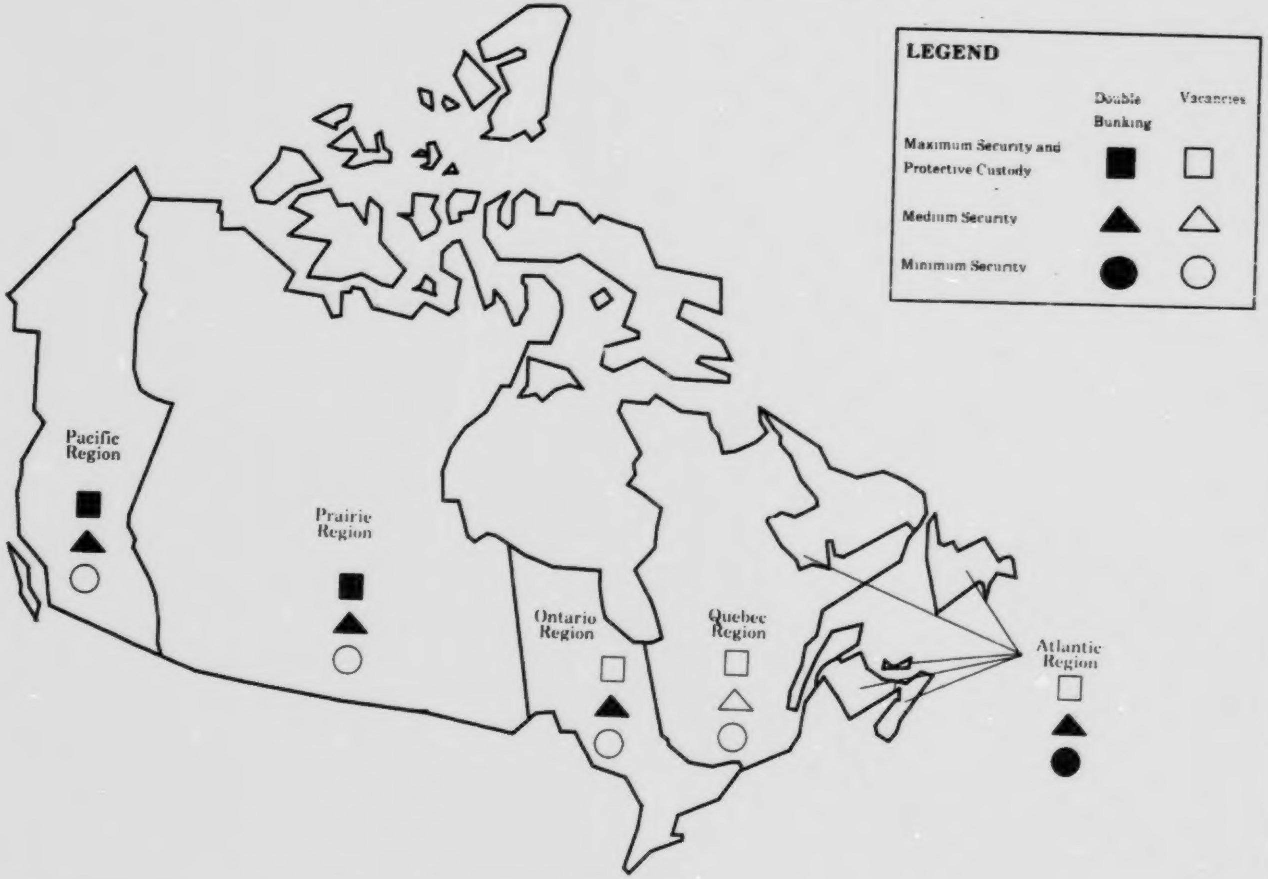
7.107 CSC has no official definition of what constitutes a significant level of double bunking. The CSC officials we interviewed indicated that the negative effects of double bunking – increased risk of violence, for example – become more significant as double bunking increases. These effects include insufficient opportunities for education, training, and employment of inmates, and restriction on personal space, resulting in disruptive and aggressive behaviour by the inmates.

7.108 Nationally, the percentage of CSC inmates double bunked was 7 per cent in February 1986. However, in 10 out of 61 institutions, representing 34 per cent of the total inmate population, double bunking was over 10 per cent and ranged up to 38 per cent of the inmates. The highest level of double bunking was at the Protective Custody and maximum security levels in the Pacific and Prairie regions. The situation during other months of 1985-86 was similar. Exhibit 7.4 illustrates where vacancies and double bunking existed in February 1986. With the national average of double bunking rising from 7 per cent in 1985-86 to 27 per cent in 1993-94, double bunking in individual institutions could become more serious.

7.109 CSC is monitoring the double bunking situation in the institutions and has identified a number of solutions to alleviate the problem. Besides building permanent

Exhibit 7.4

FEBRUARY 1986
CSC INSTITUTIONS
VACANCIES AND DOUBLE BUNKING BY SECURITY LEVEL


LEGEND
Double Bunking
Vacancies
Maximum Security and Protective Custody ■ □
Medium Security ▲ △
Minimum Security ● ○
Pacific Region ■ ▲ ○
Prairie Region ■ ▲ ○
Ontario Region □ ▲ ○
Quebec Region □ △ ○
Atlantic Region □ ▲ ●

additional accommodation, these solutions include exploring alternatives to incarceration, greater use of exchange of service agreements with the provinces, extension of Community Residential Centres, and temporary accommodation such as trailers.

> A statement from CSC: *CSC aspires to a principle of one inmate to one cell as articulated by both the Canadian Criminal Justice Association and the United Nations Standard Minimum Rules for the Treatment of Prisoners. The overriding factor that comes into play is the current prevailing reality of economic restraint and the continuing realization that escalating construction costs may not be the most cost-effective way to utilize scarce resources available for correctional programs. Through the continuing use of alternative sentencing strategies and federal-provincial initiatives such as exchange of service agreements, CSC will continue in its attempt to keep double bunking to a minimum.*

Project Management

7.110 We examined CSC's management of three capital projects:

- construction of a new Protective Custody institution at Renous, New Brunswick (called Atlantic Institution), with a cell capacity of 250, at an estimated cost of $61.5 million;
- construction of a new maximum security institution at Drummondville, Quebec (called Drummond 1), with a cell capacity of 252, at a cost of $40.5 million; and
- expansion and upgrading of a medium security institution at Bowden, Alberta, to a cell capacity of 400, at a cost of $42 million.

The total cost of these projects is $144 million.

7.111 The purpose of our review was to determine whether, in the management of these projects, CSC exhibited due regard for value for money and complied with Treasury Board and internal policies and procedures for the management of capital projects.

7.112 We examined various stages of the management of the three major capital projects:

- **Needs identification.** In CSC's context, this means determining that there is a need for a certain capacity at a certain security level and place.
- **Options analysis.** This means identifying the viable options to meet the identified need, evaluating them and selecting the most cost-effective option.
- **Pricing and availability.** This involves a more precise definition of the cost and time to complete the selected option, by using a list of potential contractors.
- **Project definition.** This involves translating the selected option into a project in terms of its objectives, work packages, milestones, budgets and controls.

- **Project implementation.** This involves awarding the work to the appropriate contractor(s), carrying out construction and other work and monitoring the progress of work and costs.

- **Evaluation.** This involves evaluating the completed project to determine whether it meets the operational requirements and submitting a report to Treasury Board.

7.113 **Needs identification.** In its long-range accommodation plans submitted to the Treasury Board in 1980 and 1981, CSC identified the need for the three projects – a Protective Custody institution at Renous, New Brunswick (Atlantic Institution), a maximum security institution at Drummondville, Quebec (Drummond 1), and a medium security institution at Bowden, Alberta. The forecasts of inmate population available to CSC at the time justified the need for a medium security institution at Bowden, in the Prairie region. However, there was insufficient justification for building a Protective Custody institution at Renous and a maximum security institution at Drummondville (see Case Studies 1 and 2).

7.114 **Options analysis.** The options analysis supporting the three projects was performed by CSC as part of a national analysis for the long-range accommodation plans in 1980 and 1981. The projects were among the options recommended to and approved by Treasury Board.

7.115 The analysis met the Treasury Board requirements to the extent that it identified and evaluated viable alternatives to meet the identified need. However, it made cost comparisons mainly on the basis of initial capital costs. Operation and maintenance costs were considered but not over the full life-cycle of the alternatives. In this respect, the analysis did not meet the Treasury Board standards. CSC has informed us that it has recently taken action to take full life-cycle costs into consideration in comparing alternatives.

7.116 **Pricing and availability.** CSC adequately performed the pricing and availability phase for Bowden and Drummond 1 institutions by developing a precise definition of costs. However, the pricing for the Atlantic Institution was not defined precisely because of external pressures affecting its location and uncertainties regarding its design and scope.

7.117 **Project definition.** The project definition phase for the three projects was performed without formally approved or consistent performance standards. Further, there was a delay of up to two years in issuing instructions on certain security-related specifications. As a result, several construction components with significant security implications were not determined until well into the planning and construction phase. This led to changes in design with additional costs totalling $3.3 million. This is explained as follows.

7.118 Project definition is done in two stages – concept design and detailed design. For the concept design stage, CSC had informed Treasury Board in 1981 that a "Statement of Institutional Performance Specifications " would be issued for each institution to guide the building design and to form a basis for evaluating the planning and operational suitability of the institution on completion. These statements were issued for Bowden and Drummond 1 institutions but were not used. For Atlantic Institution, a Master Development Plan was issued and used. We have been told by CSC that it is now using Master Development Plans for its institutions. In his 1984-85 annual report, the CSC's internal auditor mentioned that "the non-existence, incompleteness and uncertainty of the status of master development plans for institutions was reported in 6 of 10 reviews". The internal auditor did not pursue the matter further in 1985-86.

7.119 The detailed design was to be based on a "Building Program", a document specifying qualitative and quantitative requirements. In 1979, this program had been replaced by "CSC Technical Criteria". The engineers and architects on all three projects found these criteria to be incomplete in some areas, or inconsistent with each other.

7.120 At Atlantic Institution, the cost of design changes made after Treasury Board project approval, amounted to $1.5 million. In addition, as a result of the cancellation of the Special Handling Unit, CSC incurred a contingent liability of $1 million to a contractor, and an unnecessary cost of $144,000 for constructing a tunnel linking the Protective Custody Unit with the now cancelled Special Handling Unit. This tunnel was to provide access from the Special Handling Unit to the kitchen facilities, industries program and visiting areas.

7.121 At Bowden, design changes relating to security resulted in extra costs of $1 million.

7.122 At Drummond 1, change orders resulting from instructions issued in October 1983 and requirements to meet criteria for an S-6 institution resulted in change orders totalling $800,000.

7.123 CSC has informed us that the design changes were mostly due to frequently changing operational and security requirements, and that during the last two years, it has refined its technical criteria and has been trying to stabilize its requirements.

7.124 **The Correctional Service of Canada should ensure that standards and requirements are specified before defining the design of a new institution and that subsequent changes are kept to a minimum.**

> *CSC's response: CSC will increase its efforts to ensure that standards and requirements are specified as much in advance as possible of the design of a new facility.*

7.125 **Project implementation.** We noted that once the project scope and design were approved, tenders for construction called, and Treasury Board approval to award contracts received, construction started quickly. However, as a result of inadequate controls over design changes, there were frequent changes to the designs after the contract award amounting to $9.4 million. Examples of these change orders follow.

7.126 At Atlantic Institution, as a result of major design changes following the award of contracts, additional construction costs totalling $4.6 million were incurred. These changes included adding brick cladding over concrete walls, at an additional cost of $1.7 million, to provide business to brick manufacturers in New Brunswick.

7.127 At Bowden, change orders resulted in an increase of $1.6 million in the contract costs. Major elements of the planned agri-business for Bowden were cancelled after $148,000 had been spent on the infrastructure. In addition, a newly painted Dissociation, Segregation and Health Unit was repainted a different colour at a cost of $26,000.

7.128 At Drummond 1, as a result of requests for changes, additional costs of $3.2 million were incurred. Included in these costs were $140,000 to have a smoother finish on the walls, even though the original finish had been completed as specified; and an additional $24,500 spent on repainting, due to a change in choice of colours.

7.129 As of 30 April 1986, design change orders totalled 103 for Bowden, 396 for Drummond 1, and 104 for Atlantic Institution, for a total of 603. Although most change orders were for less than $20,000, the total amount was $12.7 million including $3.3 million due to project definition without formally approved or consistent standards. This is about 14 per cent of the construction cost of the three projects (excluding land and equipment) – approximately 3 times what is considered acceptable by the construction industry – up to 5 per cent. Although we realize that the environment in which CSC builds its institutions is to a certain extent different from that of the construction industry, we think that the above mentioned differential is still significant.

7.130 The total costs of the three projects remained within costs as approved by Treasury Board. However, while the costs of Bowden and Drummond 1 remained within individual approved project costs, the cost at Atlantic Institution in Renous is expected to exceed the approved project cost as adjusted to reflect cancellation of project elements. This is explained below.

7.131 Atlantic Institution was approved by Treasury Board for a capacity of 350 (Protective Custody: 250, Special Handling Unit: 100) at a cost of $73 million. This included the costs of the Special Handling Unit at $12.8 million, and the Bark Heating plant at $1 million. Since these two items have been eliminated from the project, we have adjusted the approved cost to $59.2 million. CSC says the expected cost is now $61.5 million for a 250 cell institution and that a new Treasury Board submission to reflect the revised cost will be made.

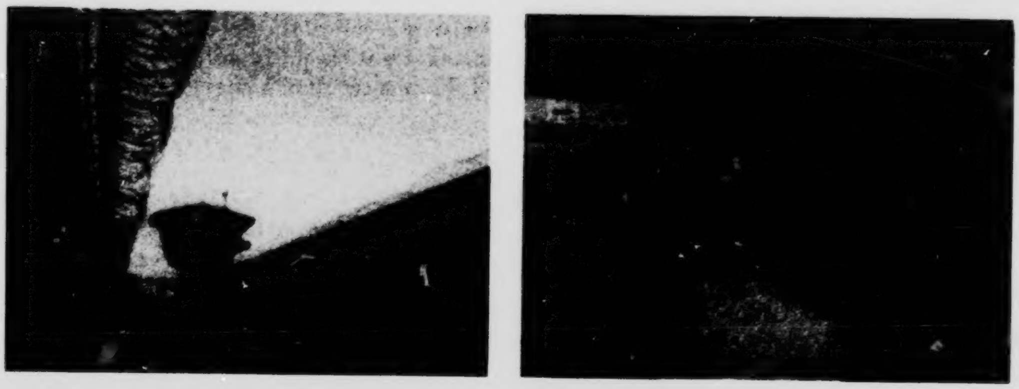
7.132 In our opinion, the cost of $61.5 million for a Protective Custody/maximum security institution of 250 cell capacity is excessive by approximately $10 million. The excess was caused mainly by the fact that the infrastructure and core facilities were designed for a cell capacity of 350 (250 for Protective Custody and 100 for Special Handling Unit). When the Special Handling Unit was cancelled in 1985 (which was about two years after the work on the project was started), work on the infrastructure and core facilities had advanced to a point where it was not practical to do otherwise than proceed with their construction. If the institution had been designed initially for a cell capacity of 250, the cost would have been approximately $10 million lower. Thus, the late decision to cancel the Special Handling Unit resulted in CSC not receiving value for money for an expenditure of $10 million. The decision to cancel the Special Handling Unit was made by CSC as a result of a change in the forecast for inmates requiring special handling.

7.133 The Correctional Service of Canada should adhere to established standards and should set up adequate controls to avoid unnecessary changes and resulting additional costs during the construction phase of its capital projects.

> *CSC's response: The report notes that changes were introduced at an additional cost but does not mention that changes were also responsible for some $19 million in offset reductions. It is the position of CSC that the majority of the identified "avoidable costs" resulted from changing operational and security requirements and would not have been significantly affected by better adherence to standards and quality control. Nevertheless, CSC will continue in its efforts to adhere to established standards, recognizing that programs and economic conditions will often preclude these plans.*

7.134 **Evaluation.** Treasury Board requires that once a project has been completed, a post-occupancy evaluation project report must be submitted to the Board. The Board has not specified any time limit for the report. Since only Drummond 1 has been completed so far, only a report in respect of Drummond 1 has become due. Drummond 1 was completed in March 1984. As of 30 June 1986, no report had been submitted by CSC to Treasury Board. In November 1985, jointly with the Department of Public Works, CSC completed an evaluation assessment report. This report identifies issues to be addressed in the post-occupancy report. Our review of the evaluation assessment report indicated that the descriptions and the issues raised in it are correct but incomplete. The report raises such issues as the causes and effects of changes on project definition and construction, but does not address directly the evaluation of the issues of performance, time or cost. We are therefore of the view that CSC has not fully complied with the Treasury Board requirement on post-occupancy reporting.

> *CSC's response: Regarding the auditors' observations that no post-occupancy evaluation project report on Drummond was ever submitted to Treasury Board, our records indicate that a detailed post-occupancy evaluation assessment was completed in conjunction with Public Works Canada in November 1985. In view of the depth of this study, it was felt that no further evaluation is required.*



Perimeter Intrusion Detection System - an electronic surveillance system to detect escape attempts (see paragraph 7.135).

Perimeter Intrusion Detection System (PIDS)

7.135 CSC is implementing a five-year plan, started in 1982-83, to install a perimeter intrusion detection system (PIDS) in 18 old and 9 new maximum and medium security institutions. PIDS is an electronic surveillance system designed to improve perimeter security of an institution by detecting escape attempts.

7.136 According to the cost-benefit projections submitted by CSC to obtain Treasury Board approval for PIDS, the installation was estimated to cost $38 million – $23.4 million for the old institutions and $14.6 million for the new ones. Two major benefits were identified. First, security was expected to improve. Second, a saving of 269 person-years was anticipated; 173 in the old institutions and 96 in the new ones. The total value of the savings was estimated at $10 million a year.

7.137 Our audit consisted of a review of the planning and implementation of PIDS. Our purpose was to determine whether the plans for PIDS were consistent with program needs and were made with due regard for economy and efficiency; whether CSC had established adequate controls over the installation of PIDS to ensure that it was completed efficiently and on time; whether the expected benefits were likely to be realized; and whether CSC had been providing adequate information to Parliament and Treasury Board on the costs and benefits of PIDS.

7.138 As of April 1986, PIDS had been installed in 12 of 27 institutions. A mid-project review by the Bureau of Management Consulting concluded that the final actual costs for equipment and installation appeared to be within the initial estimates. As for the benefits, the first relating to improved security has been realized. The wardens we interviewed were pleased with the performance of PIDS. As of 30 April 1986, there had been no escape attempts that had not been detected by PIDS. However, the second benefit of person-year savings has been only partially realized. Compared to the projected savings of 173 person-years in old institutions, the wardens now expect to realize a saving of 112. The shortfall of 61 has been attributed by CSC mainly to the fact that the initial estimate of person-year savings was inaccurate. It was based on post standards that were higher than the actual staffing level of perimeter posts. These post standards were subsequently reduced, but the estimate of the person-year savings was not revised to reflect the reduction. Hence, not all person-years initially identified for savings were available for reduction. Other reasons were less than expected savings on walled institutions and an unforeseen requirement to staff watch towers during recreation hours even after PIDS had been installed. Even on the basis of the savings reported, PIDS will be more cost-effective than other alternatives that CSC considered during the planning phase.

7.139 There has been a delay of up to 46 months in completing some of the PIDS installations. This has resulted in projected lost savings of $6.5 million, representing the value of the deferred person-year savings up to December 1987, based on the person-year savings now expected to be realized. CSC has told us that this delay is due to a change in priorities and to a moratorium, placed by senior management, on PIDS installations in walled institutions.

7.140 We noted some instances where the information relating to PIDS, provided by CSC in Part III of the Estimates and the Solicitor General's Annual Report, was inconsistent from year to year (see paragraph 7.268).

Inmate Population Management

Case Management

7.141 Case Management is the process of managing inmates throughout their sentences. The primary objective of Case Management is to meet the security and program needs of the inmates. The ultimate objective is to prepare them for their return to the community as useful/law-abiding citizens. The 1985-86 Offender Case Management budget was $163 million, of which approximately $40 million related to social and community affairs, psychology, and chaplaincy.

7.142 Each inmate's security needs are identified during initial penitentiary placement. Based on available information, a Case Management officer determines the inmate's security classification. The inmate is then placed in an institution, based on this classification.

7.143 Following initial penitentiary placement, the next step in the Case Management process is individual program planning. CSC considers this to be the most critical aspect of Case Management. It involves identifying each inmate's needs for programs and services and developing a plan to meet the inmate's identified needs.

7.144 Needs identified during the individual program planning phase fall into a number of areas. For example, the Case Management officer may identify areas of concern related to education, training, personal development, family/community contact, and health.

7.145 Following the development of the individual program plan, it is the role of the Case Management officer and other staff to monitor the progress of the inmate. Regular progress reports are to be completed to reflect the inmate's progress in relation to his or her individual program plan.

7.146 Case Management staff are also responsible for preparing each inmate's case and making recommendations for decisions concerning institutional transfer, conditional release, and so on. A progress summary, containing an overall assessment of the offender's progress and a recommendation on the decisions to be made, is required at this stage.

7.147 The primary objective of our audit of Case Management was to assess whether satisfactory procedures were in place to measure the effectiveness of the program in meeting the needs of inmates.

7.148 Our audit consisted primarily of constructing a model of Case Management indicating its activities, outputs and objectives, interviewing CSC staff at the national, regional and field levels, and reviewing departmental reports, studies, policies and manuals.

7.149 Case Management is responsible for ensuring that opportunities for improvement and treatment are available to those inmates who need them. As noted earlier, Case Management staff attempt to do this by carrying out a needs assessment on each inmate, developing individual program plans and producing regular reports to indicate inmate progress.

7.150 File reviews by CSC regional headquarters staff and our own file review at two institutions revealed that all of this is documented in the form of reports on the individual inmate files. However, since this information is not aggregated in a systematic way on an institutional, regional or national basis, there is no routine way in which key performance and planning indicators can be produced.

7.151 There are no indicators of the extent to which inmate needs are being met by programs and services nor are data readily available on the regional distributions of various types of inmate needs. For example, recently the Service needed information on the prevalence of various types of mental disorders. Since information was not being aggregated routinely, the study team had to do a manual review of over 9,000 inmate cases. Since there is no ongoing system for collecting and reporting this information, it will be necessary to undertake another extensive case review when this or other information on inmate needs is required in the future.

7.152 The Correctional Service of Canada should measure the extent to which the needs of the inmate population are being met.

> *CSC's response: The Service remains firmly committed to its policy and practice of ensuring that the needs of the inmate population are being met. The discussion in the report of needs identification as it relates to aggregate needs does not distinguish between the needs of all inmates and needs of groups of inmates*

> *within a specific population. By way of example, all inmates require family and/or community support and, as such, programs such as visiting and social development are provided and encouraged on a Service-wide basis. On the other hand, a group of inmates within a specific population at a specific time may have common needs. The needs may be identified and met in a variety of differing ways. CSC agrees that it is equally important to measure the extent to which inmate needs are being met and is currently examining numerous methods of ensuring this. In the past, these methods have been, by and large, manual, and CSC recognizes that given our large and diverse client population, other automated methods may be more relevant. In this regard, the Service's single most expansive automated system development project, Offender Management System (OMS) will address, among other things, identification and eventually concordance of needs with available programs.*

Education, Training and Employment of Inmates

7.153 The Education, Training and Employment Branch is responsible for the following programs: Industries, Automated Document Processing, Education and Training, Agriculture Operations, and Inmate Incentives/Resource Management. The Branch objective is

> to maximize employment, training and educational opportunities for all offenders in preparation for their reintegration into society by increasing the Correctional Service's capacity to provide meaningful work and training opportunities, by increasing, where appropriate, the emphasis on work programs that will generate revenue to help offset the operating cost of the Service and by effectively supporting the efforts of released inmates to find gainful employment.

During 1985-86, the Branch had a budget of $77 million and 759 person-years.

7.154 We examined the performance measures used by CSC to assess the efficiency and effectiveness of the Industries and Education and Training programs. These programs together account for 75 per cent of the expenditures of the Branch and generate approximately 90 per cent of inmate employment within the Branch. This accounts for about 38 per cent of total inmates available for employment in CSC.

7.155 The audit included a review of inmate files, documents and reports. It also involved visits and interviews with officials at national and regional headquarters as well as at a number of shops and vocational/academic facilities in Ontario, Quebec and Prairie institutions.

7.156 **Industries.** The major activities of the Industries program consist of production and marketing.

7.157 Goods are manufactured at 22 institutions throughout Canada in 83 different shops. Major products include upholstered and modular office furniture, modular shelving, cell furniture, shoes and clothing. Services include graphics, repair of mail bags and postal

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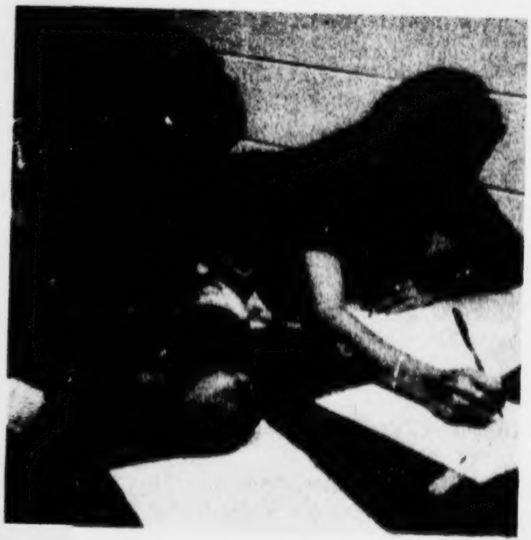

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Inmates prepare for return to the work environment: 1. Industrial workshop. 2. Literacy teacher (right) instructs an inmate. Combating the 18% illiteracy rate is a priority for the education program. 3. Upholstery workshop. 4. Ballot boxes made for a government contract. 5. Word processing: one of a wide range of "office of the future" programs. 6. Farm superintendent shows off cabbages grown by inmates (see paragraph 7.153).

equipment. Most products and services are currently sold to federal government departments and agencies.

7.158 All products are marketed under the registered trademark CORCAN with marketing being directed from national headquarters. Regional sales staff co-ordinate national sales at the regional level, conduct regional market assessments and assume responsibilities for timely delivery of regional products.

7.159 The objectives of the Industries program are to produce goods in a cost-efficient manner so as to maximize CORCAN's contribution to overhead, to develop good work habits in inmates and to give the inmates the opportunity to learn transferable skills.

7.160 During the audit, we identified several unique constraints that have a significant negative impact on the ability of program managers to achieve the above-stated objectives. Four major constraints are:

- Under the Penitentiary Act and Regulations, CSC is restricted to selling goods and services to federal, provincial and municipal governments and to charitable, religious or other non-profit organizations.
- CSC agreements to supply products to federal departments are usually documented in memoranda of understanding. CSC is expected to produce to this expected demand. The federal government departments have not been given direction to give priority to purchasing from CSC.
- Labour productivity is negatively affected by inmate absences from work for reasons such as visits, appointments with counsellors, and medical appointments. Staff estimate absenteeism to be between 30 per cent and 60 per cent. Production is also negatively affected by educational and skill levels that tend to be lower than those normally found in the industry.
- At the institutional level, the top priority is considered to be employing inmates. This implies that inmates are busy and in turn, contribute to maintaining good order in the institution. Emphasis on this priority can lead to over-staffing shops and/or producing goods in cases where inventory levels do not justify continued production.

7.161 **Effectiveness and efficiency measures.** Currently, the Industries program is highly centralized. The production activities are co-ordinated and directed by national headquarters staff, and the majority of marketing activities take place in the national capital region. Our findings relating to the extent to which existing indicators measure the achievement of program objectives are set out below.

7.162 The information collected to measure the maximization of contributions to overhead costs is adequate. In fact CSC is to be commended for having undertaken, since 1981, a number of initiatives to better monitor the Industries program and its cost-efficiency. Improvements include implementing production quality controls, testing a new cost accounting system, and providing monthly, instead of annual, financial statements for senior managers at national headquarters and regional offices.

7.163 It should be noted that in the 1981 audit, we commented that CSC did not have adequate cost accounting and unit production data, that the contribution from each product group was not measured and that there was no formal system to measure and report on the use of plant capacity. The above-mentioned initiatives and other improvements, once fully implemented, will address all of the significant inadequacies.

7.164 The remaining program objectives are to develop good work habits and transferable skills. Currently, how to operationalize these program objectives is not clear to program managers. This was demonstrated by the diverse responses received from program managers when asked to describe their understanding of good work habits and transferable skills. There are also no consistent national indicators in place to measure the development of good work habits or the learning of transferable skills. Clear program objectives and the identification of performance measures are required for proper planning, control, implementation and evaluation of the program. For example, targets such as quantity of work, (output per inmate), quality of work (percentage of rejections), attendance, and punctuality would focus the efforts of program managers and provide effective feedback on program effectiveness.

7.165 The finished goods inventory of CORCAN products has increased rapidly in comparison to actual sales, from 26 per cent of sales in 1981-82 to 82 per cent in 1985-86. As of 31 March 1986, inventories were estimated at $6.3 million compared to sales of $7.7 million during 1985-86. According to CSC, this increase was the result of a decision to meet customer requirements promptly by satisfying orders from stock rather than production. Our review indicated that other factors probably contributed to this situation. For example, CSC does not sufficiently determine the marketability of each product line, and it has a practice of manufacturing to inventory as a method of creating work for industrial shops. Its inventory control system does not include indicators of "minimum" and "maximum" quantities to keep in stock. And until recently, CSC had not ranked its objectives for the Industries program. In addition, CSC has not sufficiently explored regional and local markets for its products.

7.166 The Correctional Service of Canada should clearly define and communicate the Industries program objectives and key targets related to the development of good work habits and learning of transferable skills. It should also develop and use measures to assess the extent to which these objectives and targets are achieved.

> *CSC's response: The former Industries Program has recently been revitalized under a new Offender Policy and Program Development Branch. The new Occupational Development Program Division, which includes Industries, Agribusiness and other private sector joint venture programs, has recently completed a draft of its first Strategic Planning Framework. Program Objectives, Key Targets for work habits and transferable skills and measures to assess attainment have been addressed in the Framework document.*

CSC realizes that there is considerable work yet to be done; however, through recent departmental reorganizations and the completed Strategic Planning Framework, feels that the concerns contained in this recommendation are currently being addressed.

7.167 **The Correctional Service of Canada should assess constraints placed on the Industries program and, where possible, reduce these constraints to make it easier to achieve the objectives of the Industries program.**

> *CSC's response: The Service could not agree more with the essence of this recommendation and, to the extent possible, will continue to work toward the reduction of constraints affecting this Program.*

7.168 **The Correctional Service of Canada should implement appropriate controls relating to finished goods inventory levels, develop existing markets and explore other markets to which it can sell its products.**

> *CSC's response: The size of the Service's finished goods inventory is admittedly large and is being addressed in the Strategic Planning Framework referred to in our response to recommendation 7.166. More specifically, optimum levels of inventory have been established and the groundwork set for implementation of appropriate controls on these levels through the decentralization/regionalization of CAROL (Corcan-Accounting and Reporting-On Line). (This is the automated accounting system for Industries).*
>
> *With respect to the marketing portion of the recommendation, CSC's sales efforts will continue to emphasize sales at a regional and local level and toward clients other than the federal government. CSC does, however, have to respect federal legislation with regard to whom it may sell.*

7.169 **Education and Training.** The Education and Training program offers accredited academic and vocational courses to inmates in 27 institutions. The program involves three activities – the delivery of courses, library services, and liaison with provincial and other educational authorities.

7.170 The objective of the program is to prepare inmates for their return to the work environment by providing them with opportunities for academic and vocational training leading to recognized certificates of achievement or skills.

7.171 We reviewed the Education and Training program to determine if adequate information was available to decision makers for planning the various education and training programs and monitoring their efficiency, and whether the key program objectives were being measured and reported to decision makers.

7.172 **Effectiveness measures.** Even though national headquarters is responsible for developing broad policy direction, establishing priorities and monitoring the program, we found that, with the exception of enrolment data, no effectiveness information was being collected to assess the extent to which the Education and Training program objective was being achieved. The information that could be collected includes, for example, courses successfully completed, failure rates, participation rates and average length of stay in programs. Such information would enable an assessment by staff at national headquarters of whether regions/institutions were meeting program objectives, whether current policy and priorities were adequate, and whether changes should be made and resources reallocated.

7.173 At the regional level, where the main responsibility is to monitor institutional performance, we found that effectiveness data was being collected but that it varied significantly from one region to another. A comparison of regional responsibilities and available information indicated that additional and consistent effectiveness measures are needed such as credits earned by program area, length of stay in courses and attendance.

7.174 At the institutional level, the key responsibilities are the delivery and direct supervision of the programs and the compilation of information relating to the progress of inmates. To fulfil these responsibilities, the institution should collect information on an inmate's personal development, such as attendance, attitude, training objectives, academic and vocational achievement. This information could then be used to assess the success of the various Education and Training programs and provide the inmate, upon release or transfer, with clear documentation of his or her achievements. This information would also be useful for counselling inmates as well as for developing an inmate's personal plans. Our review of performance measures and information at the institutional level revealed that institutions generally do not collect adequate information with respect to educational progress and achievements.

7.175 **Efficiency measures.** National headquarters has developed several indicators to assess the efficiency of Education and Training programs. A review of information and reports available at the regional level indicates that efficiency measures collected by the regions do not vary significantly from the data collected by national headquarters. These indicators are reasonable, given the roles and responsibilities of national headquarters and regional headquarters. The indicators include cost per inmate based on full-time equivalency enrolment; teacher/student ratios; staff/student ratios and design utilization.

7.176 A major concern related to the collection of efficiency measures is that some indicators have not been compiled and reported since January 1986, while others have not been reported since March 1985. Appropriate program monitoring, control and allocation of funds are difficult without this information.

7.177 Information about an inmate's educational and training background and progress in the Education and Training program, in addition to the information on the development of good work habits in the Industries program, would provide useful data for CSC in assessing an inmate's progress. Our interviews at the institutional level showed that this kind of information, when collected, is not communicated regularly in CSC and particularly to Case Management staff.

7.178 National headquarters of the Correctional Service of Canada, in conjunction with the regions and the institutions, should develop key indicators on the effectiveness of its Education and Training program and ensure that they are applied consistently across regions and rolled up nationally. It should also establish national guidelines on the type of effectiveness information that should be collected at the institutional level.

> *CSC's response: Through a reorganization at national headquarters, the former Education and Training Division has been reorganized under the Offender Policy and Program Development Branch and is now the Education and Personal Development Division. This new Division recognizes that management data have not always been available at national headquarters on effectiveness and efficiency measures. This problem is being addressed through two major projects currently under way:*
>
> - *a project to develop standards that can be used in the ongoing monitoring of the effectiveness of the Education and Personal Development programming within CSC; and*
>
> - *a project to clarify the statistical base of the Education and Personal Development Programs; i.e., cost analysis such as cost per inmate, value for dollar, etc.*
>
> *With respect to national guidelines on information collected at the local level (institutional level), a Task Force is expected to be established by the end of September 1986 to address this issue.*

7.179 The Correctional Service national headquarters should prepare a report on a periodic basis that incorporates efficiency and effectiveness measures from all regions.

> *CSC's response: The Service will, through the projects identified in our response to the recommendation 7.178, address this issue.*

7.180 The Correctional Service should ensure that information about an inmate's educational and training background and progress in the Education and Training program, as well as information on the development of good work habits in the Industries program, is shared between the Education, Training and Employment Branch and Case Management.

> *CSC's response: Prior to the report of the Organizational Review Task Force (ORTF), separate organizational structures existed for Education, Training and Employment and Case Management. The ORTF recommended and the Senior Management Committee subsequently approved the integration of all Offender Policy and Program areas under a single Deputy Commissioner. This unification should streamline functioning and improve communication so as to ensure all information is shared.*

Inmate Grievance System

7.181 Both the Canadian Criminal Justice Association and the American Correctional Association standards require that all inmates have access to an inmate grievance procedure that provides for levels of appeal.

7.182 We audited the CSC's Inmate Grievance System to assess the adequacy of its design and operation. We compared the design of the Inmate Grievance System, as described in Commissioner's Directives and Divisional Instructions, with the Canadian and American correctional standards. We examined the operation of the system by reviewing 139 inmate grievance files at 7 institutions to determine whether reasons for decisions and action to be taken were specified, whether responses to grievances were within specified time limits and whether grievants were notified in cases where there were delays in processing grievances. In addition, we examined 53 files at 3 regional headquarters and 23 files at national headquarters to determine whether appeals were being responded to within the specified time limits.

7.183 In our opinion, the design and operation of CSC's Inmate Grievance System is generally satisfactory. The system provides levels of appeal from the institutional to the regional and national levels as well as access to privileged correspondence with individuals such as the Solicitor General and an independent Correctional Investigator. Divisional Instructions contain provisions for written responses to all grievances within a prescribed time limit.

Management of the Correctional Officers (CX) Group

CX Recruitment, Training and Development

7.184 Our audit of human resource management examined CSC's recruitment, training and development of Correctional Officers (CXs).

7.185 CXs are the main employment group in CSC and are in daily contact with the inmates. In 1984-85 there were approximately 4,100 CXs. This represented 40 per cent of the total CSC strength. In the preface to its 1983-84 report, the Carson Committee underlined the importance of the CX group as follows:

> The relationships that develop between staff and inmates are at the heart of corrections and we firmly believe that effective programming and control will ultimately flow from getting those relationships right.

7.186 In 1977, the MacGuigan report made it clear that many of the operational problems experienced by CSC could be linked to the poor quality of its correctional staff. MacGuigan saw the security staff as poorly recruited, under-educated for the job and not adequately trained in technical and human relations skills. This resulted in high turnover, particularly of younger staff, with the remaining officers being "captured" in a job with limited opportunities for advancement. As part of our 1981 audit, we commented on the lack of financial and management control being exercised over the costs of training.

7.187 During the first half of the 1980s, management took several steps to overcome these deficiencies in CX human resource management. For example, CSC:

- implemented a formal, national recruitment program to ensure an adequate supply of candidates to all regions and the consistent identification and selection of candidates against a set profile and in accordance with affirmative action goals;
- upgraded, in practice, selection requirements to university/college graduation to improve the quality of correctional staff;
- implemented a 14-week national training program for CXs and centralized the management of training and development to improve financial control, ensure consistency in course content and delivery, and to provide national scope in CX development opportunities.

7.188 By 1985, CSC had addressed most of the deficiencies identified by MacGuigan and our 1981 Report. However, some of the initiatives were causing concerns; for example, national recruitment was cutting CSC off from some local communities as its traditional recruitment base, and the almost exclusive recruitment of university/college graduates was changing the traditional mix of the CX group.

7.189 Since 1985, CSC has made significant changes in CX recruitment, training and development policies and practices. A new recruitment policy now allows a more flexible intake of candidates to include those that do not have a college or university education; the training program for recruits has been reduced from 14 to 8.6 weeks; and the management of training and development has been decentralized. These modifications have been made to achieve broad corporate objectives such as cost reduction and decentralization. While we do not question these corporate objectives, we are concerned that they were made without sufficient consideration for their impact on the overall CX recruitment, training and development program. In this context we have observed the following:

- The linkages have not been completed to connect the selection profile for recruitment with the induction training course content.
- We have seen no evidence that the decisions to regionalize training and development and to reduce recruit training were considered from the point of view of their impact on the effectiveness of meeting total training needs.
- Capital assets of approximately $7 million in the Kingston and Laval staff colleges were being significantly underused at the time of our audit, compared to 1984-85, when they were running at almost full capacity. This was mainly due to reduced recruitment caused by the suspension of most capital construction projects during 1985-86 and a reduction in the length of recruit training.
- The decision to regionalize the training budget has been made without implementing adequate financial and management controls such as performance measures, particularly efficiency measures.

We recognize that CSC carried out a number of studies during 1985-86 on the subject of training. We believe that these studies were initiated to implement decisions to regionalize and reduce costs. They did not address the issue of training effectiveness.

7.190 **In its evaluation of Correctional Officer recruitment, training and development, the Correctional Service should ensure that its objectives, policies and practices are integrated and contribute to the effective and efficient management of the group.**

> *CSC's response: CSC agrees that training programs need continually to be evaluated to ensure that there is an integrated approach, consistent with the corporate direction and contributing to sound human resource management.*
>
> *CSC is, however, concerned about the appropriateness of the supporting text. The auditors indicate that modifications to training programs have been "made without sufficient consideration for their impact on the overall CX recruitment, training and development program." The contrary appears to be more correct in that a number of proposals were put forward to the Senior Management Committee and the most appropriate option chosen. Similarly, studies were completed to ensure appropriate use of capital assets and scarce fiscal resources in times of restraints.*
>
> *In fact, CSC is presently looking at improving its overall management of the CX group by developing the Unit Management system as the basic organizational model of CSC. Unit Management is intended to provide a structure for institutional operations that will meet the current policy objectives of the Service and make the best possible use of resources in achieving our mission. Part of that project will be to re-evaluate and ensure that recruitment, training and development are integrated.*

Overtime Control

7.191 In 1982, we reported on the management of overtime throughout the public service. That report showed that CSC was the second highest user of overtime after Transport Canada. CSC used 11 per cent of the total government overtime budget.

7.192 During the planning phase of our audit, we found that overtime costs, as a percentage of total salary costs, had been increasing over the past three years – from 8.6 per cent in 1982-83 to 9.5 per cent in 1984-85. We followed up on the findings in our 1982 Report to determine whether effective measures had been taken to control the use and costs of overtime.

7.193 Our audit scope included interviews and document analysis at national headquarters, the Quebec, Ontario and Prairie regional headquarters, and two institutions within each of these three regions.

7.194 In 1984-85, CSC spent $29 million on overtime. This represented 9.5 per cent of its total salary budget. Our audit focused on the $21.7 million spent on overtime for the CX group.

7.195 Our first observation is that CSC has not developed a means to assign the cost of overtime to the various causes of it. Since scheduling of overtime can be a chain of events – for example, the person scheduled to cover the person on CX refresher training calls in sick and must now be covered by overtime – it is difficult to attribute the cost to the cause. Was the absence because of training or because of illness?

7.196 There are difficulties with attribution. Because CSC cannot assign costs to causes, it cannot define the significance of the various components of overtime, isolate problems, develop solutions, and set and measure the achievement of goals.

7.197 We worked with CSC officials to develop a methodology to analyse the causes of overtime and assign estimated costs to them. By applying the methodology to the available data, we produced Exhibit 7.5, showing the estimated breakdown by causes of CX overtime. While not ideal, the chart still provided an analytical framework through which we could assess, on an approximate basis, the adequacy of the measures used by CSC to control the use and costs of CX overtime. We observed that solutions to the problem of CX overtime have to be directed at two levels, the policy level and the operational level. Each of these is discussed below.

7.198 Major blocks of CX overtime are incurred because of structural barriers at the policy level that are beyond the direct control of CSC. Examples are:

- The collectively bargained provisions for family-related responsibility leave effectively give CXs five days extra leave each year that can be taken at the employee's discretion. This increases the need for overtime.

- CSC contends that person-year levels are often inadequate to cover resource needs. The gap is sometimes filled through overtime.

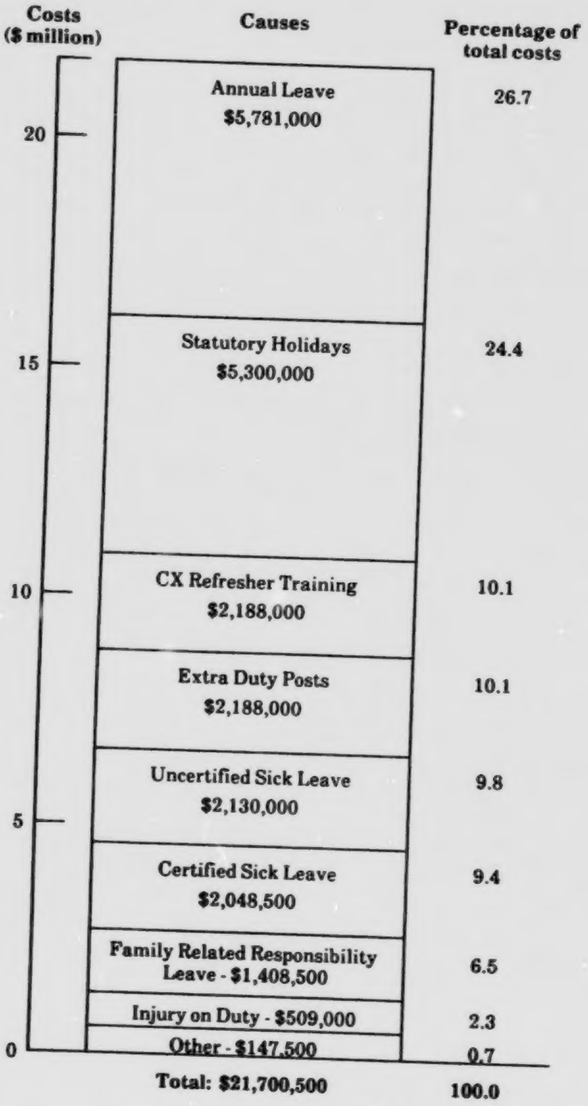
7.199 Where CSC has the power to effect changes at the policy level, it has occasionally done so. For example, by reducing CX refresher training from five to three days, there will be less need for overtime to back up staff on training.

7.200 In addition, CSC is attempting to eliminate a major policy barrier by negotiating with the Treasury Board Secretariat and the Union of Solicitor General Employees to introduce part-time staff to cover some overtime requirements. Over the next two years, CSC hopes to reduce its CX controllable overtime by 25 per cent as a result of using part-time staff.

7.201 At the operational level, we believe that improved scheduling of staff could reduce the use and costs of overtime. A variety of options is available to operational managers to avoid the need for overtime. For example, in accordance with the collective agreement, annual leave can be scheduled in consideration of operational requirements, not all posts have to be filled on all shifts, and extra staff on one shift can be reallocated to another shift where there would otherwise be a need for overtime.

Exhibit 7.5

CORRECTIONAL OFFICERS' (CX) OVERTIME OUR ESTIMATED BREAKDOWN OF CAUSES



Note: Institutions must remain open 24 hours a day, every day of the year. CSC says that it often has no option but to pay overtime benefits, for example on statutory holidays.

7.202 In our audit, we found that these types of operational decisions are not always taken. A CSC study has set an estimate of $1 million (5 per cent) as the cost incurred because of inefficient staff scheduling in CSC. We reviewed the situation in one institution and found that the cost could be over 20 per cent.

7.203 In addition, there is the issue of CX absenteeism that results in the need to adjust the shift schedule on short notice. Internal and external studies show that CSC has a major absenteeism problem. CXs took an average of six days more leave in 1984-85 than the average public servant. Most of this extra leave is accounted for in categories such as certified and uncertified sick leave and family-related responsibility leave; management has little discretion to refuse it.

7.204 A reduction of one day from the average number of leave days taken per CX would result in an annual overtime saving of approximately $750,000. Recognizing this, CSC has issued guidelines and a voluntary program for attendance awareness. Where implemented, the program appears to be achieving results.

7.205 During our audit, CSC was implementing a policy of decentralization and increased local accountability for the operational level control of overtime. As a result of this policy, overtime budget ceilings are to be set and allocated to institutions through the regions. Managers are then to be held accountable for managing within these ceilings. Our only concern about this approach is that ceilings are not based on an analysis of need. The overtime budget ceilings may still be greater than the actual need for overtime. During 1985-86, CSC reduced its total overtime costs by $4 million compared to the previous year; $1 million on CX overtime, and $3 million on other overtime. Part of this reduction may be due to the approach described above.

7.206 **The Correctional Service of Canada should develop and implement a means of measuring the need for overtime in each institution. Taking local circumstances into account, this information should be used to set and monitor overtime budgets.**

> *CSC's response: Previous and current CSC management has been very concerned with overtime management; this concern was in evidence as early as 1981 with the initiation of the Kulik Study and as recently as 1986 with the study of part-time CX employees. Over the years, the same fact has held true: overtime is a complex issue affected by many inter-related factors and myriad daily operational management decisions. All CSC studies and efforts have resulted in the conclusion that management action at all levels (institutional, regional and national) can contribute to reducing the overtime costs; however, it is management at the local level that can best determine the causes of excessive overtime and thus deal with it.*
>
> *The recommendation and supporting analysis which the auditors provide in support of their recommendation are very difficult to grasp. While it adds little to our knowledge of the causes of overtime or the methodologies of studying the problem and offers no new insights or strategies, it recognizes the complexities of the issue and lauds some of our initiatives.*

In fact, fiscal year 1985-86 has seen an actual decrease in overtime costs and all seems to indicate that a further decrease will occur in fiscal year 1986-87.

In the text leading to this recommendation, the auditors have included a display (Exhibit 7.5) that they purport illustrates the causes of overtime in CSC shown as a percentage of total (overtime) costs. The exhibit contends that the Service expended $5.3 million or 24.4 per cent of overtime expenditures, paying for CX staff coverage on statutory holidays. The Correctional Service must pay for the coverage as operational reality tells us the correctional institution cannot simply be closed down, nor is the Service in a position not to pay overtime benefits on these days. It might be more appropriate that the definition of overtime be amended and statutory holidays not be included. If this were the case and the reality of a twenty-four hour a day, seven-day a week operating Service were recognized, CSC might not be the second highest user of overtime in government and our percentage of the total government overtime budget would be less than the 11 per cent the auditors quote.

We will continue to address this issue of overtime in light of our operations.

Support Services

Management of the Financial Function

7.207 We reviewed the organizational structure, the staffing and the role of the financial function in key management processes.

7.208 According to Part III of the Estimates, the mandate of the financial function at CSC is to administer CSC's financial support systems, including the design and maintenance of general and cost accounting systems, and to provide regular financial analyses and advice on existing and new program proposals.

7.209 The financial function does not always fulfil its financial analysis and advice mandate partly because senior and operating management rarely request this assistance. The Finance Branch has only sporadically provided analysis and advice on its own initiative. In our examination of major capital projects and systems development projects, we did not find any evidence of the involvement of the Finance Branch in the financial analysis of the alternatives to the proposed projects. CSC has undertaken initiatives to hand over certain of its operations to the private sector, including food services in most regions. The Finance Branch was not involved in analysing the cost-effectiveness of these initiatives.

7.210 In May 1986, at the request of the Assistant Commissioner, Administrative Policy and Services, a management consulting firm completed an organizational study of the national headquarters Finance Branch. The report identified, among others, the need for strengthening the role of the Finance Branch in providing financial analysis to management.

7.211 One way of encouraging adequate financial advice on decisions involving major financial implications is to have strong financial representation on the Senior Management

Committee. Until 1985, the Director General, Finance, who is the full-time senior financial officer, was a member of the Senior Management Committee. Finance is now represented instead by the Assistant Commissioner, Administrative Policy and Services, who, in addition to being the senior financial officer, has several other responsibilities besides Finance, such as personnel, data processing, technical services, and administration. We have been informed that, starting in 1986, the Director General, Finance, usually attends and participates in Senior Management Committee meetings when items having financial implications are discussed.

7.212 The Finance Branch of the Correctional Service should perform financial analysis on each major initiative and project prior to its approval, or should review the analysis prepared by operating personnel.

> *CSC's response: In support of the reorganization and downsizing exercises, the mandate of the Finance Branch was reviewed by a group of management consultants. Part of their conclusion was that the Finance Branch get much more involved in providing the level of financial analysis and advice necessary to senior management as input to their decision-making process. In fact, since the start of fiscal year 1986-87, Finance has been increasingly directed by senior management to perform these services.*

Materiel Management

7.213 Materiel includes all moveable public property, equipment and stores, other than cash. Consequently, materiel management deals with operating supplies as well as machinery and equipment.

7.214 In our 1981 audit, we recommended that CSC should implement procedures to ensure that materiel needs are met with due regard to economy and develop an inventory management system throughout the Correctional Service. In 1981, an internal audit of materiel management concluded that CSC "did not have adequate systems and procedures in place to ensure due regard for economy and efficiency in the procurement, use and disposal of goods and services required to meet CSC needs and objectives".

7.215 CSC has devoted an estimated $1 million to improving its materiel management practices and systems over the past five years. In particular, CSC management has taken steps to reduce the scope of the stock-keeping function and has identified improvements required in systems and procedures. In 1985, a study of the productivity of the materiel management function, done by a consultant, indicated that the Service could save approximately 10 to 20 per cent – 14 person-years – by operational improvements and reorganization at the institutional level. In addition, CSC believed that it could save another 16 person-years through improvements at the regional supply centres. As of 30 June 1986, the savings had not been realized.

7.216 Our audit of materiel management sought to determine the extent to which our 1981 recommendations had been implemented and the degree of compliance with Treasury Board directives and guidelines.

7.217 The accounting controls over materiel are inadequate. Several inventory records are maintained throughout CSC. They are not consolidated or reconciled to the CSC's financial accounting records. As a result, CSC does not know the value of the materiel for which it is responsible, nor is the financial information adequate for management decisions on materiel acquisitions, replacement or disposal.

7.218 CSC management has recognized these problems and proposes to continue its systems development efforts. Its objective is a comprehensive materiel management system to bring all CSC assets under accounting and operating control.

7.219 **The Correctional Service of Canada should implement appropriate controls over its materiel to enable it to know its value, to safeguard it, and to make informed decisions relating to its acquisition, replacement and disposal.**

> *CSC's response: The Service recognizes these problems and proposes to continue its systems development efforts. Our objective is a comprehensive materiel management system, which will eventually bring all CSC assets under more adequate accounting and operating controls.*

7.220 **The Correctional Service should review why the potential person-year savings on the materiel management function have not been realized. If such savings are deemed feasible, the Service should develop and implement plans for realizing them.**

> *CSC's response: The Service will undertake to review its calculations of potential person-year savings on the materiel management function and to take appropriate action.*

Contracting

7.221 CSC makes extensive use of professional and special service contracts to acquire a variety of services. The 1985-86 budget for these contracts was $72 million, representing 9 per cent of the total CSC budget of $796 million. In 1983-84, CSC spent $10 million on management consulting contracts and was thus the largest user of such contracts among federal government departments.

7.222 Since 1983, CSC's contracting procedures and practices have been the subject of considerable concern to Treasury Board and to CSC management. This concern surfaced in June 1983, when, following the Auditor General's 1982 Report on a government-wide study of contracting, the Secretary to the Treasury Board wrote to all government departments asking them to review and improve the controls over their contracting procedures and practices. Although CSC was not one of the departments included in the Auditor General's government-wide study, a CSC internal audit in 1982 confirmed that CSC shared with other departments most of the deficiencies identified by the Auditor General. These deficiencies included inadequate definition of requirements, inadequate justification of suppliers, letting contracts without tender, splitting contracts to avoid exceeding departmental authority limits, and commencing work prior to awarding a contract. Most of these deficiencies related to personal service contracts. In 1983-84, a financial audit, carried out by our Office, indicated that most of the deficiencies continued to exist.

7.223 We have reviewed the existing controls over contracting for professional and special services in CSC to determine whether they reflect due regard for value for money and are consistent with the Treasury Board's policy on contracting. We also reviewed a sample of professional and special service contracts at national headquarters and in the Quebec and Ontario regions.

7.224 We noted that since 1983-84, CSC has taken major steps to improve its controls over contracting.

7.225 First, in 1984, CSC requested the Bureau of Management Consulting to review the contracting procedures and practices at national headquarters. The Bureau concluded that the challenge and control mechanism over contracting at national headquarters was not effective and did not ensure the accountability of senior management for service contracts. Accordingly, it recommended that:

- the CSC Executive Committee assume the role of a Contract Review Committee;
- contract approval authorities, other than for contracts with former public servants, be assigned to Branch Heads; and
- the contract manual be revised to reflect the proposed changes.

7.226 Second, consistent with the above recommendations of the Bureau, the present Commissioner took over, on an interim basis in 1985, the review and challenge of all contract proposals at national headquarters.

7.227 Third, in March 1986, CSC established a Contract Review Board to challenge and approve all contract proposals requiring approval at national headquarters.

7.228 Fourth, the Commissioner appointed a Task Force to recommend a strategy to improve controls over contracting. The Task Force, in its final report of June 1986, concluded that the Contract Review Board at national headquarters had functioned well and recommended that similar procedures be established in each of the five regions. The Task Force also attached a guide to contracting to its report. CSC's Senior Management Committee approved the report of the Task Force in June 1986.

7.229 The present process for contracting at national headquarters provides for an improved mechanism for review and challenge to requests for contracts. CSC has thus taken important and positive steps to improve its controls over contracting. Although it is too early for us to assess their impact, we noted in the sample of contracts reviewed by us that there was generally a better documentation of the need for a contract and the justification for sole source contracting. We noted, however, that there was a need for further improvement in certain areas and we have brought these to the attention of management. We will be following up in our next audit the impact of the initiatives that CSC has recently taken.

Management Information Systems

7.230 Our audit of CSC's management information systems function mainly involved a review of its policies and procedures for the development of automated systems and the interrelationship between CSC's automated information systems and those of the National Parole Board.

7.231 It is important for managers to have adequate information to make informed decisions, maintain proper control and ensure accountability. In CSC, a significant portion of this information is collected by computerized systems. In 1985-86, CSC budgeted some $16 million for developing and operating electronic data processing systems. A large part was devoted to systems that provide management information.

7.232 The most significant of CSC's management information systems is the Offender Information System (OIS). It contains basic information on each inmate such as sentence length, parole eligibility date, security level and institution where incarcerated. Among other things, the system is useful for preparing various statistical reports on current and projected inmate populations. These statistics can be used by management to identify situations of overcrowding and to develop plans for modifying existing institutions or building new ones.

7.233 During 1982-83 and 1983-84, CSC developed and piloted a number of new management information systems. These included the Operational Based Costing and Reporting (OBCR) System, the Warden Information System (WIS), and a Graphics System for displaying management information. Some 15 other significant projects, including the system to replace OIS, were being developed or planned around this time in the Systems Directorate, other headquarters branches and in regional headquarters.

7.234 In late 1984, there were several significant changes in senior management. In early 1985, a freeze was put on all systems development activities. The reason for this decision was that users of the existing operational systems were dissatisfied because they had identified a large number of requirements that the new systems were not meeting. In addition, the information that they were getting was inadequate, there was no long-term plan to co-ordinate the development of the large number of initiatives under way, and the base budget for systems development was insufficient.

7.235 Subsequently the OBCR, WIS and Graphics System were cancelled. CSC estimated that the costs associated with the design, development and implementation of these three systems was around $2 million. Reasons given for the cancellation were that priorities had changed and that users did not accept or support the systems. This was partly because of insufficient training in the use of these systems and the information available from them, and insufficient user involvement in the design and development phases of these new systems.

Furthermore, CSC's needs analysis was inadequate and no cost-benefit analysis had been carried out.

7.236 Most important of the systems development activities that were cancelled was a project to replace the present OIS with a new offender information system. Management was concerned about the completeness and accuracy of the data in the existing system and justified the new system because it would provide more comprehensive, reliable and timely information for decision making. This, in turn, management believed, could lead to a saving of approximately $24 million in capital outlay because penitentiary construction could be deferred and operating costs reduced in the order of $6.6 million annually.

7.237 Management determined that these savings were possible because better information would be available for placing inmates upon incarceration, cascading them through the security levels more rapidly and preparing their parole applications on time, thus leading to a more appropriate and timely parole. The system was also expected to contribute to improved safety for the staff, the public and the inmates.

7.238 In the fall of 1984, CSC estimated that the new system would cost $27 million over four years. By the time of the 1985 development freeze, $500,000 had been spent on developing the new offender information system.

7.239 CSC is currently carrying out a full feasibility study with a view to replacing the present OIS. A long-range systems plan is also being prepared outlining systems development priorities. The target date for the completion of this plan was 30 September 1986.

7.240 There is a significant amount of information exchanged among the CSC and the National Parole Board (NPB) and the Royal Canadian Mounted Police (RCMP). Although much of this information is computerized in all three organizations, the exchanges with CSC are manual rather than automated. A study carried out by the NPB showed that savings in excess of $250,000 annually are possible by using an automated exchange of information between the NPB and CSC. It would also lead to more timely and accurate information.

7.241 There are signs of improvement in this area. An agreement was signed in January 1986 between the heads of the NPB and CSC to improve information exchange. CSC is also developing a strategy and action plan to link CSC systems with the Canadian Police Information Centre network, an RCMP computer network. It is too early to tell how soon results will be seen from these initiatives.

7.242 As mentioned earlier, CSC is moving toward decentralized management and decision making. In such an environment, it is important that CSC have improved management information systems so it can control operations efficiently and effectively under a decentralized management structure.

Audit and Evaluation

Internal Audit

7.243 The internal audit function of CSC is the responsibility of the Inspector General who reports direct to the Commissioner. The Senior Management Committee, chaired by the Commissioner, acts as the departmental Audit Committee. The Inspector General's Branch performs three major types of audits – financial audits, personnel audits and management reviews, the latter being operational audits of management at all levels of the organization. In addition, the Branch is responsible for internal special inquiries/investigations on behalf of the Commissioner. The budget for internal audit was $1.5 million and 23 person-years in 1985-86.

7.244 Our audit of CSC's internal audit function consisted of determining whether the function is organized and performed according to the Office of the Comptroller General Standards for Internal Audit in the Government of Canada. It was also designed to determine the extent of reliance we could place on the internal audit for the purpose of our audit of other CSC operations. We reviewed five areas of the internal audit function – its authority and mandate, its organization and staffing, the scope and planning of its work, the performance of its work, and reporting and follow-up.

7.245 We found that the internal audit function meets the Office of the Comptroller General Standards in the areas of authority and mandate, organization, and reporting and follow-up. However, we had some concerns about a proposed change in the internal audit role relating to the audit of institutions. In October 1985, CSC's Senior Management Committee approved in principle a recommendation of an internal Task Force on Organizational Review to change the role of the Inspector General's Branch "from auditors to audit co-ordinators, policy and standards development with regions responsible for institutional reviews, except periodic 'spot audits'." In our view, this implied a transfer of responsibility for institutional audits from the Inspector General's Branch to CSC regional managers. Since details of the proposed reorganization were not available, we could not determine whether senior management would continue to be assured of independent and objective reporting on the affairs of the institutions and whether the change would be cost-effective. The Commissioner has since asked the Director General, Corporate Policy and Planning, to review the situation and propose an internal audit policy for consideration by the Senior Management Committee in October 1986.

7.246 The planning process, including the priority and frequency criteria for audits, meets the Comptroller General's Standards. These criteria were being adhered to in most cases. The Inspector General's Branch is undertaking an audit universe project to ensure that all organizational units, systems and functions are included in its scope.

7.247 Although the internal audit staff is generally well qualified, there is a lack of adequate expertise in value for money and computer auditing. Even though the Inspector General's Branch has taken some steps in recent years to improve the efficiency and quality of the performance of its audit work, documentation of its work continues to be inadequate. Deficiencies in the performance of the audit work include the following:

- audit programs are rarely used;
- statistical sampling techniques are not employed;
- tests performed and conclusions drawn are not always documented;
- the audit approach for management reviews is based on "wall-to-wall" auditing rather than being focused on the most significant areas; and
- there is a lack of documented evidence of file review by supervisory staff.

7.248 As a result of these deficiencies, it is not clear that the internal audit function is using the most efficient audit approach or whether the intended audit work is carried out fully. There is inadequate assurance that sufficient and appropriate audit evidence has been obtained to support conclusions.

7.249 In view of the above findings, our reliance on the internal audit was mainly in the area of compliance with the existing policies and procedures.

7.250 **The Correctional Service of Canada should clarify the role, responsibilities and reporting authority of the Inspector General's Branch in relation to the audit of institutions.**

> CSC's response: *The report appropriately mentions that as a result of significant organizational changes and redefined mandates and scope of work, the role of the Inspector General's Branch has changed. The Organizational Review Task Force report initially recommended a framework which cast the role of this Branch as Audit Co-ordinators at the institutional level; however, it left the mandate open for individual institutional audits at the request of the Regional Deputy Commissioner or at the direction of the Commissioner. Therefore, the role and responsibilities and reporting authority of the Inspector General's Branch in relation to the audit of institutions has been clarified in the Organizational Review Task Force Report and was approved at the September 1985 Senior Management Committee meeting.*
>
> *In addition, the Commissioner has instructed the Director General, Corporate Policy and Planning, to complete a further more in-depth review of the Inspector General's Branch.*
>
> *This study, which will be completed in September 1986, will provide more precision to the role of the Inspector General as it relates to the audits of institutions. It is anticipated that this study will be presented to the Senior Management Committee in the fall of 1986.*

7.251 **The Correctional Service's internal audit function should strengthen its expertise in the value-for-money and computer auditing areas. It should modify its audit approach for management reviews by focusing more on significant areas. It**

should also increase the use of audit programs, use statistical sampling techniques where appropriate, and adequately document its work.

> *CSC's response:* *The Service agrees that internal audit will need to be strengthened in the areas of value for money and computer auditing. The Branch will continue to modify its approach for management reviews by focusing more on significant areas, by using more appropriate audit tools and documenting fully its work.*

Program Evaluation

7.252 Until April 1986, program evaluation was the responsibility of the Evaluation and Special Projects Division. The program evaluation function had a budget of $800,000 in 1985-86 and its Director reported to the Deputy Commissioner, Policy, Planning and Administration Branch. A recently completed internal organizational review recommended that the Division be split into two organizational units – Program Evaluation, reporting to the Director General, Corporate Policy and Planning, and Special Projects, reporting to the Assistant Commissioner, Administrative Policy and Services.

7.253 At the time of our 1981 audit, CSC's program evaluation function had just been established and we were therefore not in a position to comment extensively on its adequacy.

7.254 Our current audit consisted of reviewing the management and conduct of program evaluation at the corporate level of CSC.

7.255 A satisfactory mandate for program evaluation has been established, but CSC officials, including senior management, have failed to comply with provisions of the CSC policy on program evaluation and the related Treasury Board policy circular. In particular, most program components are not being evaluated every five years as required by departmental policy, and a number of major components, such as Security of Inmates, Education and Training, Industries and Institutional Case Management have never been evaluated. Although the program evaluation plan provides for coverage of these areas, there has been considerable slippage in the past few years mainly because the function has been carrying out "special projects" rather than the evaluations required by the plan.

7.256 We found no documented evidence of discussion of study findings or approval of the studies by CSC's Senior Management Committee or the Commissioner. Therefore there is no concrete basis for follow-up. Until 1986-87, CSC had not reported specific program evaluation findings in Part III of the Estimates. Based on all this, we concluded that the current program evaluation function in CSC does not represent satisfactory procedures for measuring and reporting program effectiveness on a periodic basis.

7.257 **The Correctional Service of Canada should ensure that the program evaluation function is carried out in accordance with the specifications of the Commissioner's Directive and the Treasury Board policy circular on Program Evaluation.**

CSC's response: *The Service agrees with the essence of the comments and finds the observations to be substantially correct. We have already started to put appropriate emphasis on program evaluation. In fact, the Commissioner and the Senior Management Committee have reaffirmed the role of the Program Evaluation function and approved a set of evaluation principles. In addition a new evaluation plan will be submitted to the Senior Management Committee in the fall of 1986.*

Reporting to Parliament

7.258 CSC's two major reports to Parliament are Part III of the Estimates and the CSC chapter in the Solicitor General's Annual Report.

7.259 Part IIIs are submitted to Parliament two months before the beginning of each fiscal year. Over the last five years, the preparation of this report has been co-ordinated by CSC's Finance Branch. This responsibility was recently transferred to the Corporate Policy and Planning Branch.

7.260 CSC has produced annual reports for over a century. The annual report became a chapter in the Solicitor General's Annual Report in 1966 and adopted its current format in 1982 when CSC began publishing Part IIIs. Since that time, the annual report has borrowed heavily from Part III financial data. The annual report is produced by the Public Affairs Branch and is published approximately 10 months following the close of the fiscal year.

7.261 In July 1985, the Office of the Comptroller General reviewed the 1985-86 Part III Estimates of CSC and generally concluded that the form and contents of the Part III complied with the Comptroller General's policy and guidelines. It noted a need for improvement in certain areas, such as more detailed information on long-term major capital programs, and more complete information on financial changes.

7.262 The objectives of our audit were to determine whether information provided in Part III of the Estimates and the Annual Report accurately portrayed CSC and was sufficient to enable their readers to make an informed assessment of the Service's plans and performance. It was also meant to determine whether the reports met the policies and standards of the Office of the Comptroller General. Our audit included a review of these two reports for four years ending 1986-87.

7.263 Our review disclosed that the information given in Part III of the Estimates and the Annual Report, while generally satisfactory, has been sometimes inadequate.

7.264 The objective of Part IIIs is to provide a basis for parliamentary appropriation of funds and that of the annual report is to enhance government's accountability to Parliament through providing appropriate information on government programs. With the kind of deficiencies noted below, Members of Parliament do not always have appropriate information for effective reviews of these programs and their associated expenditures. The following are some examples of the deficiencies that we noted.

7.265 In the area of major capital projects, we noted that Drummond 1, which was being built to maximum security specifications, was reported as a medium security institution in Part III of the 1983-84 Estimates. In Part III of the 1984-85 Estimates, the same institution was reported as a medium security in the text but as a multi-level institution in the schedule containing details of major capital projects.

7.266 We also noted that in the case of some of the projects – Atlantic and Port Cartier – when CSC was required to incur expenditures to meet purposes outside its stated objective, it did not identify and disclose to Treasury Board and Parliament, the additional cost of meeting those purposes. We have recommended (see paragraph 7.68) that CSC identify and disclose such costs not only to Treasury Board or other authority approving the expenditures but also to Parliament.

7.267 An example of insufficient reporting is that of double bunking. Part III of the 1986-87 Estimates states that in 1985-86, 7 per cent of CSC inmates were double bunked. As reported by us earlier in paragraph 7.108, although it is true that the national percentage of double bunking in CSC was 7 per cent, the double bunking in 10 out of 61 institutions, representing 34 per cent of total CSC inmates, was from 10 per cent to 38 per cent. The highest level of double bunking was at the Protective Custody and maximum security levels in the western regions. Therefore the information given in Part III is not sufficient to give to its readers, an appreciation of the actual extent of double bunking in CSC and the risks involved.

7.268 An example of inconsistent reporting relates to PIDS. The 1982-83 Part III Estimates indicated that PIDS was planned to be installed in 27 major institutions. The names of the institutions involved were not given but it was stated that all installations were expected to be completed by 1986-87. In the 1983-84 Part III, the number of institutions where PIDS was to be installed was changed to 16 and the completion year to 1985-86. In the 1984-85 Part III, the number of institutions and the completion year was again changed to 27 and 1986-87 respectively, without giving any explanation for the difference.

7.269 Occasionally, the coverage given to matters reported is not in accordance with their significance. For example in the 1986-87 Part III, CSC devoted an entire paragraph to describing a purchase option on some leased equipment that was expected to save $200,000 annually. The decision to construct a Protective Custody institution at Port Cartier was disclosed as a single $61 million entry in a supplementary exhibit; it was not detailed or even mentioned in the body of the report.

7.270 CSC's reports contain statements of goals for major initiatives. These statements are sometimes changed and the changes are not usually highlighted and explained. For example, in the 1982-83 annual report, CSC stated the goals of a $76 million accommodation plan for 1983-84. In the 1983-84 annual report, the dollar amount of the 1983-84 goal against which the actual was being reported, was restated from $76 million to

$99 million. The $23 million change was not highlighted or explained. When goals and plans are changed, it is difficult to establish a standard against which to measure results. This difficulty is exacerbated when the changes in goals and plans are not highlighted or explained. In particular, we noted that this was the case when new major capital projects are initiated or significant changes are made to them.

7.271 Matters reported in the Annual Report and the Part IIIs are sometimes contradictory. Part IIIs have, until recently, been compiled in the Finance Branch; the Annual Report is produced in the Public Affairs Branch. This separation of duties could be the cause of inconsistencies between the two reports. For example, the number of institutions and parole offices operated by CSC differs in the two reports, because the two Branches use different criteria to define the facilities. To Members of Parliament and the public, external reports are the major source of information about CSC. When the two major external reports are inconsistent and contradictory, they present CSC as fragmented, and may reduce the credibility of the information.

7.272 **The Correctional Service of Canada should ensure that the information contained in its reports to Parliament is accurate, sufficient, clear and consistent. Significant changes in the information previously reported should be highlighted and explained.**

> *CSC's response: CSC has always been under the impression that information contained in its reports to Treasury Board and Parliament was accurate, sufficient, clear and consistent at the time the information was reported.*
>
> *The Service contends that, in general, it has identified and obtained Treasury Board support for the subject changes through annual Accommodation Plan submissions, bi-annual updates to the Operational Plan, and Treasury Board submissions for the specific projects.*
>
> *CSC will ensure that in the future, information in its Annual Report and in the Part IIIs is in total agreement.*

Parole Program

7.273 Parole is an inter-agency program in which CSC and the National Parole Board (NPB) are responsible for particular activities. CSC prepares each inmate's case for parole by providing information and making recommendations to the Board. The NPB is the pivotal point in the parole process since Board members actually make the decision to grant conditional release – unescorted temporary absence, day parole and full parole – and set the terms and conditions for supervision. The supervision of offenders in the community is carried out by CSC. In 1985-86, the NPB spent $15 million in carrying out its activities. During the same period, expenditures incurred by CSC parole offices were approximately $38 million.

7.274 The purpose of our audit was to assess the adequacy of the procedures for measuring the effectiveness of the Parole program. In addition, we assessed the adequacy of the interrelationship between the automated information systems of CSC and NPB. Our audit involved interviews with national and regional headquarters staff at NPB and CSC, as well as a review of departmental reports, policies and procedures. Our comments relating to the interrelationship between CSC and NPB systems are included in paragraphs 7.240 and 7.241.

7.275 Although there is no official objective for the Parole program, both the Parole Act and the interdepartmental agreement between CSC and NPB indicate that the objectives of parole are to reintegrate the offender into the community and to protect society from undue risk. One indicator of the extent to which these objectives are achieved is the recidivism rate. CSC has defined a recidivist as a person who has served time in a federal institution, been released, convicted of a new offence, and returned to a federal institution. Both NPB and CSC report the trend in the recidivism rate in Part III of the Estimates; however, each agency points out that the recidivism rate reflects the effectiveness of both agencies as well as external factors; for example, police effectiveness and sentencing patterns. This suggests a difficulty in ascertaining specific responsibility for the outcomes.

7.276 As both the NPB and CSC are involved in the delivery of the Parole program and both influence the effectiveness of the program, it is appropriate that evaluation of the program involve both agencies. It is our view that a more precise understanding of the effectiveness of the Parole program could be obtained through a program evaluation covering the roles of both the NPB and CSC. A program evaluation study should address the overall effectiveness of the Parole program. In particular, the study could look at such issues as:

- the adequacy of information provided to the NPB by CSC;
- the effectiveness of intensive supervision relative to lower levels of supervision;
- the effectiveness of using day parole at one-third of sentence rather than full parole, and the question of which "types" of offenders benefit most from this kind of gradual release; and
- the reasons for regional variation in rates of granting parole.

7.277 In our 1983 chapter on the government-wide study of program evaluation, we raised concerns about accountability for the Parole program and made reference to the fact that an interdepartmental evaluation of the Parole program had not been done, nor was one planned. At present, neither CSC nor NPB has completed any program evaluation studies of their respective program components that relate to parole nor has there been any evaluation study of the Parole program as a whole. In addition, there are no plans at present to conduct an inter-agency evaluation of the Parole program.

7.278 Over the years, many committees and task forces, most recently the Nielsen Task Force, have expressed concern over the issue of parole decision-making criteria. Our Office also raised the issue in our 1978 Report. Arguments for decision-making criteria have generally been based on the notion that such criteria would ensure equity and visibility in the parole decision-making process. The NPB's policy manual does contain a broad set of "criteria, guidelines and other factors affecting decision making"; however, their application to actual decisions is not monitored and analysed.

7.279 The Board has demonstrated an interest in the issue of establishing a system of more explicit decision-making criteria and is awaiting the results of a study on the subject, co-ordinated by the Solicitor General Secretariat. The results of this study will assist the Board in determining which factors relate to the granting of parole and parole outcome. We support the development of a system of explicit decision-making criteria. It is our view that monitoring the use of such criteria can provide useful feedback for the purpose of policy development and decision making.

7.280 The National Parole Board and the Correctional Service of Canada should work together to conduct a program evaluation of the Parole program.

> CSC's response: *The Correctional Service of Canada agrees that the Parole program should be evaluated and that such an evaluation should include National Parole Board. CSC is committed to working with the Board on any evaluation in this area and will ensure that inter-agency implications are addressed.*
>
> National Parole Board's response: *The Board agrees that evaluation of the Parole program must involve both NPB and CSC. NPB is committed to working with CSC in any evaluations conducted in the conditional release area that have inter-agency implications.*

7.281 The National Parole Board should develop and use more explicit decision-making criteria.

> National Parole Board's response: *In addition to the Ministry Secretariat study on decision making, the Board is currently conducting a strategic planning exercise that is examining policies, procedures, and practices within the Board. One part of this exercise is aimed at clarifying decision-making policies. Additionally, improved use of management information within the Board is expected to contribute to this objective.*

DEPARTMENT OF AGRICULTURE

DEPARTMENT OF AGRICULTURE
AGRI-FOOD PROGRAM

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8

DEPARTMENT OF AGRICULTURE
AGRI-FOOD PROGRAM

Introduction

8.1 **Mandate.** The mandate of the Department of Agriculture, founded on a legislative base of some 40 Acts of Parliament, is to promote the growth, stability and competitiveness of the Canadian agricultural and food (agri-food) sector, helping it to maximize its real contribution to the Canadian economy. The Department's role is being fulfilled through a combination of activities including research and development, efforts to stabilize farm incomes, improve farm management practices, overcome production problems and exploit market opportunities; and regulatory services such as disease control, quality assurance of food and meat safety aimed at protecting both consumers and food producers.

8.2 **Importance of the agri-food sector.** The agri-food sector, as defined by Agriculture Canada, includes not only agricultural equipment and supplies, farming, processing, wholesaling, retailing, restaurants and institutional food service activities, but also important associated industries such as transportation, finance, packaging and construction. It employs about 1.5 million people – 15 per cent of total employment in Canada – and contributes about one-sixth of our Gross National Product.

8.3 Consumers in Canada spend $40 billion annually on food, an expenditure that represents some 16 per cent of their disposable income. Agricultural exports exceed $10 billion annually, compared with imports of about $5 billion. Thus agriculture makes a major contribution to Canada's balance of payments and relies heavily – for as much as half of total farm cash receipts – on export markets.

8.4 Food processing is the largest processing sector in Canada, with sales exceeding $40 billion and a workforce of a quarter of a million employees. The food service sector employs around 360,000 people, while food retailers employ about 220,000.

8.5 **Changes in the farm sector.** There have been major changes in the structure of the farm sector. Farm population declined from 2.9 million – 20.8 per cent of the total – in 1951 to 1.0 million – 4.3 percent of the total – in 1981. Over the same period, the number of farms declined from 623,000 to 318,000 and average farm size increased from 280 acres to 550 acres. The bulk of agricultural output is from the largest farms. In both the 1971 and the 1981 census, 25 per cent of farms accounted for over 70 per cent of total sales.

8.6 Farms on the whole have become more capital intensive, more reliant on borrowed capital and, therefore, more exposed to the risk of adverse market forces. Farmers have also become more reliant on the non-farm sector for fuel, fertilizers, chemicals and other production inputs. Fluctuations in international prices, as well as in interest and foreign exchange rates, can subject farmers to further financial stress.

8.7 Aggregate and average data, showing the condition of the sector as a whole, do not reveal the extent of the problems in the farming sector. Although farmers who do not have large debts enjoy a generally favourable economic position, those who incurred substantial debts during the late 1970s and early 1980s are in serious difficulty. A recent survey indicates that 23 per cent of Canadian farms with $20,000 or more in farm sales faced severe financial stress in 1984, while a further 11 per cent faced moderate stress. Current market prospects suggest little or no growth in net farm income – in some commodity sectors there could well be a decline. As a result, a continued decline is expected in farmers' net worth in the immediate future requiring that very difficult adjustments be made.

8.8 **Soil degradation.** Another important challenge facing the sector is the degradation of Canada's agricultural land which, as announced in a speech by the Minister of Agriculture, will cost about $1 billion annually. Most of this cost directly affects farmers in the form of increased chemical costs, lower yields and reduced international competitiveness.

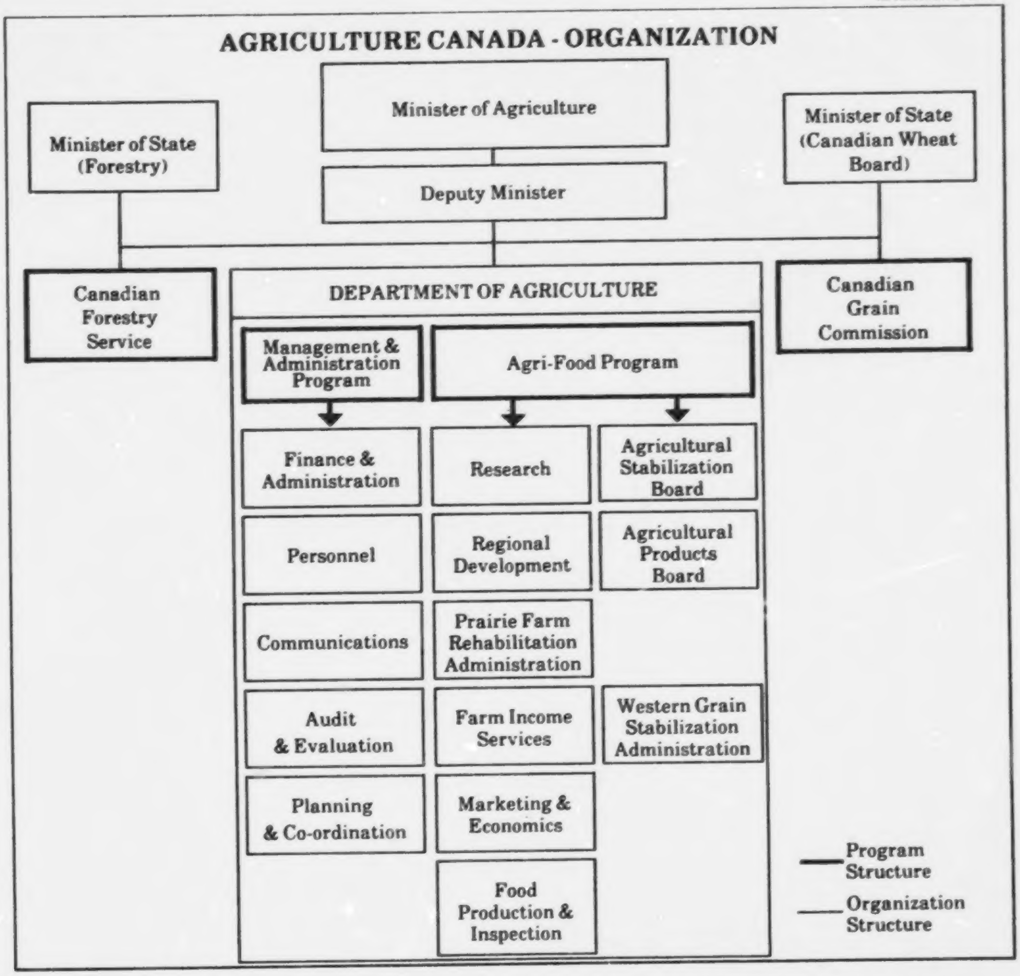
8.9 **Departmental management constraints.** Management of the agri-food sector is complicated by the sharing of jurisdictional and administrative responsibilities by two levels of government. Provincial Ministers of Agriculture are responsible for a significant portion of the Canadian agricultural sector under the jurisdiction of the provinces. Federal and provincial Ministers of Agriculture recently got together to address serious farm issues such as farm finances and agricultural trade and to develop a more co-ordinated approach to crop insurance and disaster relief.

8.10 There are about 300 associations, commissions, co-operatives, marketing boards and other agencies involved in the agri-food sector, many of which are large, active and influential. However, they often disagree in their demands, which makes the Department's role difficult in an already complex federal and provincial environment.

8.11 Domestically, the agri-food sector's two most critical and widespread problems are the farming community's financial difficulties and the sustainability of the land resource base. This stress is compounded by changing world markets. Internationally, the markets on which Canada is becoming increasingly dependent are at risk, with competition increasing and prices falling. In addressing these challenges, it will be important for the Department to create an environment in which all levels of government and industry groups work together.

8.12 **The Department's organization and structure.** Exhibit 8.1 shows the Department's four programs. The resources associated with delivering them are shown in Exhibit 8.2. The new Agri-Food program, initiated in 1985-86, consolidates the previous Agri-Food Development and Agri-Food Regulation and Inspection programs. The new structure is designed to provide a more comprehensive view of the Department's responsibilities and mandate according to the Department's most recent operational planning framework.

Exhibit 8.1


AGRICULTURE CANADA - ORGANIZATION
Minister of Agriculture
Minister of State (Forestry)
Minister of State (Canadian Wheat Board)
Deputy Minister
Canadian Forestry Service
DEPARTMENT OF AGRICULTURE
Canadian Grain Commission
Management & Administration Program
Agri-Food Program
Finance & Administration
Research
Agricultural Stabilization Board
Personnel
Regional Development
Agricultural Products Board
Communications
Prairie Farm Rehabilitation Administration
Audit & Evaluation
Farm Income Services
Western Grain Stabilization Administration
Planning & Co-ordination
Marketing & Economics
Food Production & Inspection
Program Structure
Organization Structure

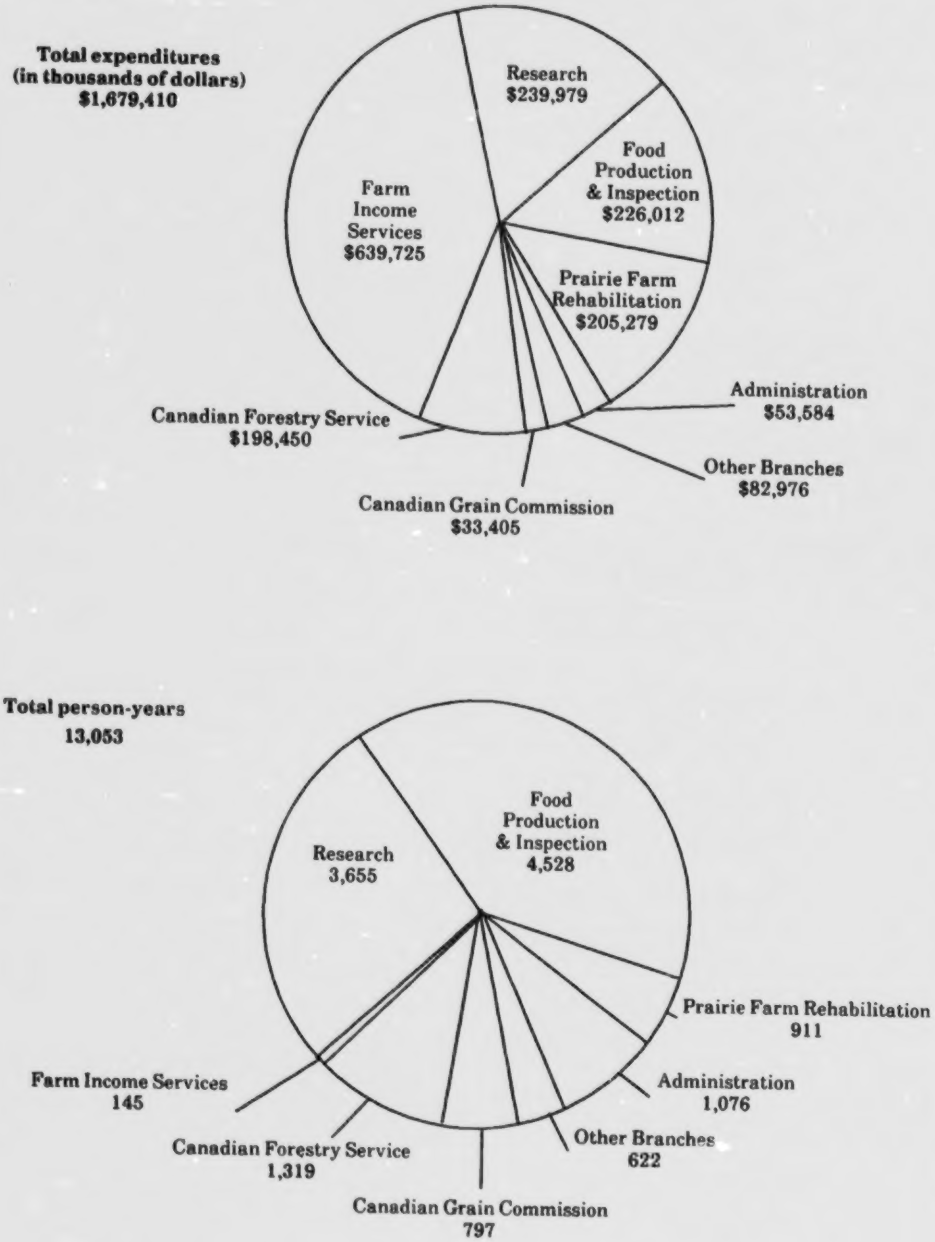
8.13 The Ministerial Task Force on Program Review (Nielsen Task Force) recommended that the Department develop market-oriented, commodity-based development strategies. The degree to which the Task Force recommendations and the government's cost-cutting directives are implemented will have an impact on departmental programs and organization.

Audit Scope

8.14 Our comprehensive audit looked separately at each of the branches we audited this year. However, in each branch, we focused on management's regard for economy and efficiency and on the procedures established to measure and report the effectiveness of programs. We did not audit the Food Production and Inspection Branch, which accounts for about 30 per cent of the program's human resources and about 18 per cent of its budget; it will be audited in 1987, together with the Canadian Forestry Service. In the Regional Development Activity, we audited only the expenditures relating to the Prairie Farm Rehabilitation Administration, which represent about 50 per cent of its expenditures, excluding emergency assistance payments.

Exhibit 8.2

AGRICULTURE CANADA
RESOURCES FOR 1985-86



8.15 In view of the stated objectives of the Agri-Food program, which emphasize the key concepts of growth, stability and competitiveness, we examined the planning for major program activities, including setting objectives and priorities. We paid particular attention to whether both costs and benefits of alternative courses of action had been analysed in making planning decisions.

8.16 About half of the Agri-Food program's expenditures are made through statutory and non-statutory grants and contributions. We therefore examined whether the related agreements, particularly in the Farm Income Services Branch, were negotiated in accordance with legislative authority and program objectives and with due regard to economy. We also looked at financial controls, performance monitoring and audit. This included a review of the way disbursements to related Crown corporations, especially the Canadian Dairy Commission, were administered.

8.17 We reviewed the information provided by the Department in Part III of its Estimates because good information is essential if Parliament is to assess the management of the Agri-Food program. We also examined the adequacy of the Department's procedures for evaluating the effectiveness of the activities that constitute the program.

8.18 A substantial portion of our previous audit of the Department of Agriculture, reported in 1982, concentrated on certain aspects of the Research Branch and the Regulation and Inspection program. We followed up our 1982 audit observations and recommendations in the areas we audited this year.

Recurring Problems

8.19 We have examined the operations of individual branches and have reported on each separately. However, we found there were the following problems that recurred throughout the Department.

8.20 The Department of Agriculture has a very high demand on its resources, particularly in view of the financial difficulties being experienced in the farming sector and the need to sustain the diminishing land resource base. We found that, in some cases where management discretion had been used, such as in making payments under the Western Grain Stabilization Act, it had resulted in payments higher than otherwise specified in the legislation. This was of concern because we did not see evidence that the Minister had been made fully aware of the financial implications of the higher payouts in relation to other support options that were available.

8.21 Linkages between programs and even branches of the Department are limited. Branches appear to see themselves as independent units rather than parts of an overall government strategy to deliver a national agricultural policy. Expected linkages between such programs as crop insurance, emergency assistance, research and stabilization payments, which could supply both economy and fairness in distribution of benefits, are not well developed.

8.22 We found that strategic planning was weak and that there had been limited success in developing meaningful and reasonable objectives and goals. This not only makes effectiveness evaluations very difficult but also prevents the Department from informing Parliament of the extent to which programs are meeting their objectives. Without a well developed long-term plan, and a set of priorities, it is also difficult to determine whether resources are being devoted to difficult and fundamental problems over the longer term rather than simply to resolving immediate concerns.

8.23 In spite of management reports of progress, there is little tangible evidence that our 1982 audit recommendations have been appropriately dealt with in the areas we audited this year. We found there had been little or no corrective action in the Research Branch, in the area of human resource management or in storing and disposing of toxic wastes and hazardous materials.

Farm Income Services Branch

8.24 The Farm Income Services Branch administers payments, including crop insurance, to stabilize the income of agricultural producers, by protecting them from short-term market instabilities and natural hazard risks, thereby also preserving the agricultural resource base. The expenditures of the Branch, for the years ended 31 March 1986 and 1985, may be summarized as follows:

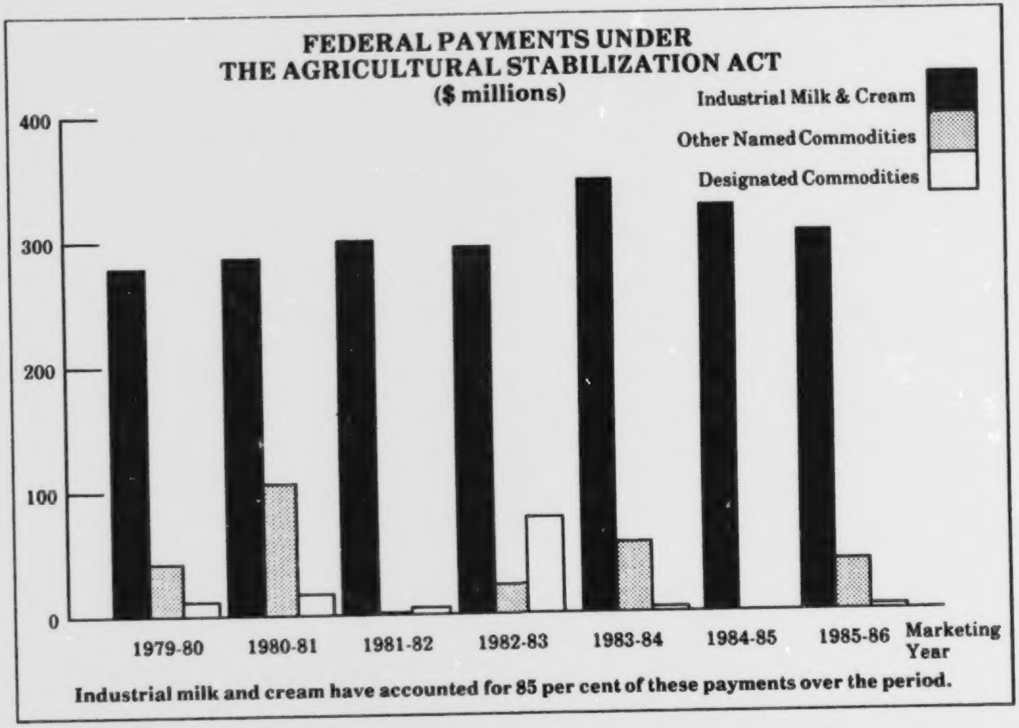
	Year Ended 31 March	
	1986	1985
	(in thousands)	
Agricultural Stabilization Board	$ 331,905	$ 410,121
Crop Insurance	198,186	188,460
Western Grain Stabilization Administration	84,330	116,907
Agricultural Products Board	8,167	14,720
Other	9,640	46,434
Administration	7,497	6,786
	$ 639,725	$ 783,428

8.25 A description of each program follows. Crop insurance operations, which represent a significant portion of the Farm Income Services Branch's activities, are described in paragraphs 8.69 to 8.93.

Farm Income Protection Programs

8.26 **Agricultural Stabilization Board.** The Agricultural Stabilization Board (ASB) provides payments to producers for named and designated commodities under the Agricultural Stabilization Act (ASA). The support rate is a prescribed percentage of the base price of the commodity; that is, the previous five-year average market price, indexed for changes in the costs of production. Commodity payments for the past seven years are summarized in Exhibit 8.3. Dairy support, which represents about 85 per cent of total ASA payments over the past seven years, has a current support level of 124 per cent of the base price. Exhibit 8.4 illustrates the significance of this support to various dairy products.

Exhibit 8.3



FEDERAL PAYMENTS UNDER THE AGRICULTURAL STABILIZATION ACT ($ millions)

Industrial milk and cream have accounted for 85 per cent of these payments over the period.

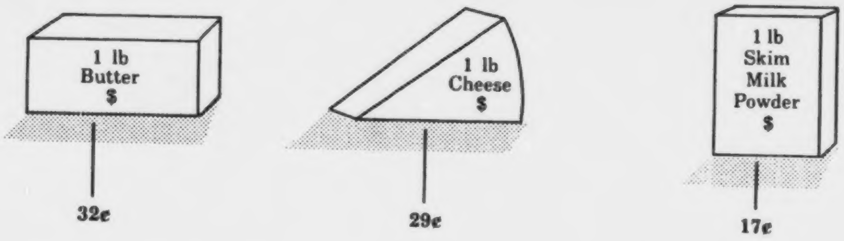
8.27 Any farmer who produces commodities named in the ASA – for example, hogs, cattle or corn – or designated by Governor in Council pursuant to the ASA – for example, apples, sugar beets or white beans – is eligible for stabilization payments. Although the ASA prescribes a minimum support level of 90 per cent of base price, this can be raised for all commodities or lowered for designated commodities at the discretion of the Minister of Agriculture subject to Governor in Council approval (dairy support at 124 per cent is an example). All eligible producers receive the same rate of payment per unit.

8.28 The ASB administers the Act. Its three members, who are employees of Agriculture Canada, are appointed by the Governor in Council. The Minister of Agriculture and the Board are assisted by an Advisory Committee representing producers.

8.29 **Agricultural Products Board**. The Agricultural Products Board (APB) is empowered by its Act to buy, sell or import agricultural products, and to administer contracts and other commodity related operations. It may purchase and hold inventories for sale and provide emergency relief in Canada or assistance programs abroad. The Board also often purchases the surplus of a product to firm up prices and thus prevent the possibility of requests arising for deficiency payments under the ASA. The net cost of support provided by the APB is usually less than other direct support payments.

Exhibit 8.4

AVERAGE FEDERAL SUPPORT COST FOR CANADIAN DAIRY PRODUCTS



Each time these products are purchased there is a support cost paid with tax dollars in addition to the price paid in the store.

8.30 The APB Act has been used to prop up the prices of a variety of commodities including sweet cherries, solid pack apples, grapes and canned tomatoes. The Board is able to contract directly and can react quickly to market conditions for perishable foods.

8.31 **Western Grain Stabilization Administration.** The Western Grain Stabilization Program began on 1 April 1976, following the proclamation of the Western Grain Stabilization Act. It helps prairie grain producers, who are subject to wide swings in cash receipts and input costs often caused by world market factors beyond their control. It provides for voluntary participation by eligible grain producers, including qualified farming companies, co-operatives and partnerships. All registered Canadian Wheat Board permit holders are deemed to be potential participants. Landlords and certain other categories are specified as ineligible.

8.32 Grain producers currently pay a levy of 1 per cent of eligible receipts from the sale of grain (up to a maximum of $60,000) into a stabilization account (under the legislation the percentage can be up to 2 1/2 per cent). The federal government pays a matching contribution plus an additional 2 per cent of grain receipts. Thus the federal government currently contributes $3 for every dollar of producer levy.

8.33 When the stabilization account builds up a surplus, accumulated funds earn interest which is credited to the account. When the account is in a deficit position, the federal Consolidated Revenue Fund makes advances to cover the shortfall. Up to 31 March 1986, there has always been a surplus, although a deficit is now forecast.

8.34 Stabilization payments are triggered when the net cash flow (the difference between gross receipts and cash expenses) during the crop year is less than the previous five-year average. Calculating this average is complex, and adjustments are made for such things as the level of participation and the proportion of grain sale proceeds covered by the program. Payments are made using the higher of two statutory methods of measurement. A participant's share of the total payout is related to the amount of levy contributed during the three most recent years.

8.35 Federal funding of the account is provided by appropriations through the Departments of Agriculture and Finance for the levies and the interest, respectively. A total of $84 million in payments for matching levy contributions has been made for 1985-86. The estimates for 1986-87 indicate a projected expenditure of $96 million.

8.36 The balance of the fund has been declining rapidly, largely because of severe reductions in cash flows caused by declining prices, increased costs of production and drought in 1984 and 1985. The balance in the fund at 31 March 1985 was $971 million; the balance of $607 million at 31 March 1986 is projected to decrease to a deficit of some $100 million by about November 1986. Payouts have been made during 1985-86 of $522 million in respect of the 1984-85 crop year. An interim payout of $580 million for the 1985-86 crop year was announced in April 1986.

8.37 Approximately 116,000 producers participate in the program. The participation rate is about 78 per cent of eligible producers. The 90 per cent target in the Act has never been achieved.

Planning and Control

8.38 Given the broad mandate of the Farm Income Services Branch and the hundreds of millions of dollars it disburses annually, strategic planning is essential, in order to manage in anticipation of future risks and opportunities and with due regard to economy and efficiency. We would expect it to involve analysing the environment and how it might affect the Branch's strategies for achieving results, analysing the Branch's strengths and weaknesses, setting objectives, determining the costs and benefits of new or revised policies, and drawing up specific plans to achieve results.

8.39 We found, however, that the strategic planning process was weak and the stated objectives of the program lacked clarity and precision. For example, there were no guidelines to indicate how officials are to interpret and measure the requirement in the Agricultural Stabilization Act that farmers should have a "fair return", or what results to expect from "stabilizing income", which it is directed to do in the Branch's operating plan.

8.40 We also noted the following deficiencies in planning and control:

- The Branch has not developed a strategic plan or established principles, policies or operating procedures for program delivery. For example, there is little focus on goals or results to be achieved, such as equitable support of commodities, a balance between federal and provincial support, maintenance of a particular farm structure, or allocation of farm resources.
- Analysis of the possible costs and benefits of different support levels for commodities is weak. For example, the Branch had no analysis of the trade-offs that showed why, during the same period, sugar beets had been supported at 80

per cent of the base price whereas hogs had been supported at 95 per cent of the base price. Variations in support levels could not be related to a strategic plan.

- There is limited measurement of program effectiveness.

8.41 Although managers are knowledgeable about their programs, their informal operating practices make accountability difficult. Also, because of the lack of documented policies and procedures, there is a risk that the departure of some of the Branch's key officials would result in a vacuum that would not be easy to fill in the short term.

8.42 The Farm Income Services Branch should develop a strategic plan for the delivery of its programs. It should also establish goals for each of its programs and document the principles, policies and operating procedures to achieve them.

> *Department's response**: The Department agrees to further pursue the feasibility of developing a comprehensive strategic plan for the Farm Income Protection programs and will:*
>
> - *revise or modify, where necessary, program goals; and*
> - *complete the documentation of the principles, policies and operating procedures associated with the achievement of Branch goals.*

Prices and Costs of Production

8.43 Although payments under the Agricultural Stabilization Act and the Western Grain Stabilization Administration, in particular, are dependent on precise information on market prices, costs of production, and so on, the Branch's costs-of-production models are not consistent and the data used are not always reliable. Even small differences in prices or cost measurement can have a very significant impact on the overall stabilization payments. For example, a calculation error of four cents in 1979 and one cent in 1980 per hundredweight in the stabilization payment for hogs resulted in a net overpayment of some $900,000.

8.44 We noted that, while there has been some improvement in recent years, the following problems remain:

- Three branches of the Department are involved in calculating the basis for subsidy payments. Responsibilities are not defined and the bases of calculation can vary. For example, long-term interest costs are included as eligible expenses in determining the subsidy payment for industrial milk but not for other named commodities. Also, short-term interest costs are treated differently for different commodities.
- Criteria and procedures for selecting and verifying price and cost data have not been documented; nor have principles and policies for developing and applying cost models.

8.45 We have been advised that several initiatives to improve the reliability of data are being considered by the Branch. These include the development of a regional data base and the use of surveys and farm models.

8.46 **In its efforts to achieve consistency and reliability in the supporting data used for calculating subsidy payments, the Farm Income Services Branch should develop and implement an appropriate system for designing, testing and reviewing costs-of-production models.**

> *Department's response: In July 1986, the Department, through restructuring, made a number of major changes which will significantly affect the operations of the former Marketing and Economics Branch, the Regional Development Branch and Farm Income Services which is now part of the new Policy Branch. This is expected to result, not only in an enhanced analytical and policy capability, but in a more direct linkage and accountability between the persons developing cost-of-production models and the persons responsible for the administration of the program. This will permit the Department to implement a system for designing, testing and reviewing cost-of-production models by December 1987.*

Reporting Program Results

8.47 We reviewed Part III of the Department's 1986-87 Estimates, the most recent annual reports of the Agricultural Stabilization Board, the Agricultural Products Board and the Western Grain Stabilization Administration, and the performance indicators in the Department's operational planning framework.

8.48 Employment and trade data, production statistics and food price data are presented as measurements of the agri-food sector's achievements, and the Department claims to have achieved its overall objectives of promoting growth, stability and competitiveness in the agri-food sector. Although this information portrays what has happened in the sector overall, it is not specific enough to indicate the real contribution of the Agri-Food program and whether the results measured were those planned for.

8.49 Performance in agriculture stabilization is also reported in terms of person-years devoted to this activity, number of producers receiving payments, amount of dollars spent, as well as work load indicators such as the number of transactions handled, volume of claims processed and the number of enquiries and payments made. Interesting as this information may be, it does not tell the reader the extent to which farm incomes have or have not been stabilized, or the agriculture resource base has or has not been protected as a result of the income protection programs. The challenge is to determine the extent to which the viability of farm operations can be attributed to stabilization payments.

8.50 **The Farm Income Services Branch should develop specific, measurable indicators of performance, to show progress toward program goals. Parliament should be informed of the levels and cost of commodity support, and these should be linked to the significance of the commodity.**

__Department's response__: The Department agrees with the desirability of specific measurable indicators and will continue to pursue their development and will make available to Parliament information to show linkages between levels and cost of commodity support, economic significance of the commodity and the degree of impact of payment on the industry.

Payments Under the Agricultural Stabilization Act

8.51 We noted several cases where payments were apparently made without due regard for economy. It may be that economy considerations have to be subordinated in certain instances in the interest of achieving other objectives, but such a decision should only be made after the costs and benefits have been developed and reviewed.

8.52 In the following examples there was no evidence to suggest that due regard was given to economy or that the authority and objectives for payments were adhered to.

- The direct subsidy paid for industrial milk and cream over the past five dairy years ended 31 July 1985 was some $32 million more than the amount to be paid according to the subsidy rate approved by Cabinet. Subsidies are paid according to butterfat content, while approval, since 1981, has been on the basis of hectolitres of milk. Also, the standard butterfat content on which subsidies have been paid was below the national average. We suggest that the government's forthcoming review of the target return to producers should consider the current national average butterfat content per hectolitre of milk.

  The January 1986 Cabinet approval of the long-term dairy policy now clarifies that the subsidy is to be paid on the basis of butterfat for a standard hectolitre of milk.

- Although the Minister stated that stabilization payments in respect of 1983-84 hog marketing would "equalize the level of protection across Canada", we noted that producers in some provinces received a higher level of protection than those in other provinces, when federal and provincial payments were combined. This was because of a flaw in the method of calculating the federal stabilization amount which did not adequately consider the varying rates of provincial subsidy. It used the number of hogs covered by the provincial subsidy rather than the amount of the provincial subsidy paid. We estimate that this resulted in payments of some $2 million more than the amount required to accomplish the Minister's objectives for producers in provinces where the rate of provincial subsidy exceeded the rate of federal stabilization.

- In several cases, calculation and other errors resulted in overpayments during the marketing years 1981-82 through 1984-85, as follows:

Program	Support Level	Total Payments (millions)	Overpayments
1982 Greenhouse Cucumbers	90%	$ 4.4	$ 930,000
1982 Eastern Canada Winter Wheat	100%	10.6	400,000
1979 and 1980 Hogs	90%	149.0	900,000
			$ 2,230,000

8.53 The Agricultural Stabilization Board also did not adequately control subsidy funds transferred to the Canadian Dairy Commission (CDC). The Commission's funding requirements over the three fiscal years ending 31 March 1986 were $70.1 million more than the amount originally budgeted, as evidenced by several amended Orders in Council. Also, a total of $100 million was given to CDC over the three dairy years ending 31 July 1985 to finance its marketing costs, without specific funding authority within the vote wording of the Appropriation Acts approved by Parliament.

8.54 The ASB also did not consider alternative ways of determining a five-year average for market price and production costs. It could be a single weighted average or a simple average of five annual averages. These alternatives yield significantly different results.

8.55 A review of calculations for ASA payments from 1981-82 to 1984-85 indicate that, if a weighted five-year average method had been used rather than averaging annual figures, stabilization payments would have been some $20 million less. We are not suggesting that one method is necessarily more appropriate than the other; program objectives and goals must be considered in determining the calculation method to be applied. However, we could not find evidence that the Board approved any methodology, endorsed one interpretation rather than the other, or set out the circumstances when either should be used.

8.56 **For payments under the Agricultural Stabilization Act, the Department of Agriculture should:**

- **clarify the division of responsibility and accountability for dairy subsidy between the Agricultural Stabilization Board and the Canadian Dairy Commission;**
- **ensure that funds are spent only for purposes for which they have been appropriated by Parliament;**

- **verify calculations supporting stabilization payments prior to making the payments, and ensure that the Agricultural Stabilization Board approves each stage of the process; and**
- **consider whether overpayments can be recovered.**

Department's response: *The Department will implement procedures related to each of the above recommendations, including recommended revision to Vote wording to clarify purposes for which funds are to be spent, by March 31, 1987.*

Agricultural Products Board Assistance

8.57 The APB is frequently involved in buy-and-sell-back arrangements for agricultural products with financially troubled companies. The Board has granted financial assistance that has resulted, in the past two years, in $3.5 million of losses of principal or foregone interest. One company was provided, contrary to the Board's decision, with a loan at a subsidized interest rate less than bank prime. The estimated value of this benefit could be some $200,000 over the term of the loan. While the financing of inventories is inherent in APB programs, there are no Board policies or specific provisions in the APBA that regulate the extension of financial assistance.

8.58 **The Agricultural Products Board should seek clarification of the conditions under which it can extend financial assistance.**

Department's response: *The Board agrees and will do so by December 31, 1986.*

Western Grain Stabilization Administration Concerns

8.59 The Department administers the Western Grain Stabilization program in accordance with the Western Grain Stabilization Act, a complex statutory instrument that provides for little discretion in implementation. However, we noted the following deficiencies that have exposed the public purse to financial risk.

8.60 **Lack of due regard for economy.** The financial implications of the method of determining the stabilization payment that was introduced in 1984 were not adequately analysed. There was also little evidence that the Minister had been adequately advised on them. In view of the fact that the new method of calculation required that the fund would pay out more frequently and in larger amounts, we would expect detailed analysis of the impact this would have on the viability of the fund over the short or long term. The Department could not produce an actuarial assessment to support the decision to adopt the new payment formula, although it stated that it considered all options to be actuarially sound. We were informed that a large surplus in 1984 was the overriding factor in the decision to increase payouts, particularly since farmers were thought to be in need of further assistance.

8.61 Also in 1984, with changes in the legislation, the Administration for the first time had a choice between its traditional aggregate cash flow method of payment and a new "per tonne" method; it was required to use the method that produced the higher payment. The Department forecast then that the fund would have a surplus of $311 million in 1988, with no deficit at any time, even using what it considered to be the worst assumptions.

8.62 Using the new method, the payout for the 1983-84 crop year was $95 million higher than if the old method had been used. For the next two crop years, using the original method has produced the higher payout. Within two years, the fund was heading toward a deficit, with net cash flows of farmers declining more rapidly than even the worst case assumption made in 1984.

8.63 **Levy rates.** Levy rates paid by grain producers are not responsive to future funding requirements but are based on historical balances. Once the levy rate comes into force it must remain for at least two years. The Administration cannot change the rate to avert potential deficits. For 1985-86 the levy rate was 1 per cent, the lowest possible. The account disbursed some $1.1 billion during the 13 months to April 1986 and is likely to have a deficit by November 1986 of about $100 million.

8.64 In June 1985, the Department recommended to the Minister that the maximum eligible receipts level – that is, the maximum it can expect to receive in levies from an individual producer – should be increased. At the current maximum eligible receipts level of $60,000, the program covers only about 78 per cent of eligible grain sales compared to the target of 90 per cent. Ultimately, the decision to increase the levy rate or the maximum eligible receipts level is at the discretion of the Minister.

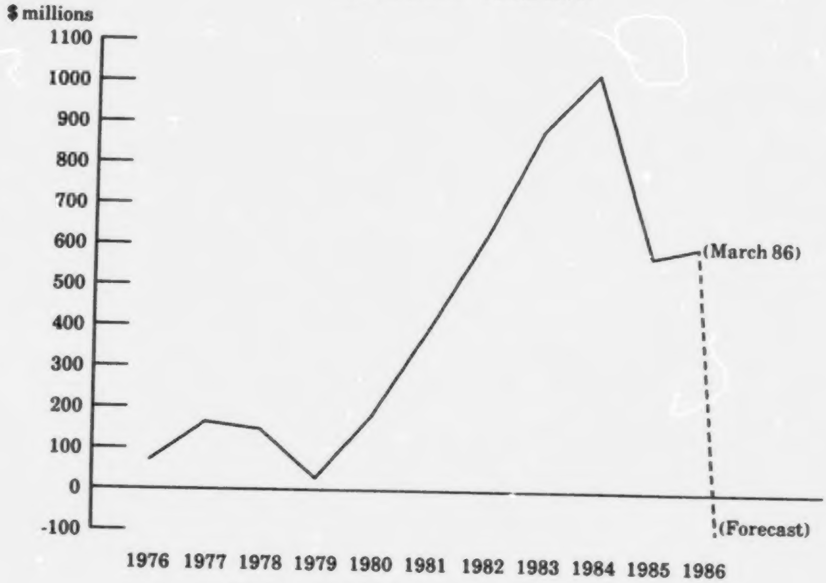
8.65 **Payout calculation.** In calculating the stabilization payment, the Department based its calculation on the assumption that the current maximum eligible receipts level was the same in each of the previous five years, although it was substantially lower in three of those years. This results in a much larger payout than otherwise specified by the Act, except for a provision that there may be "such modifications as the circumstances require". We have calculated that such discretionary modification to the payout calculation resulted, for the 1984-85 crop year, in payments that were approximately $185 million higher than they would have been if the actual maximum eligible receipts level for each of the previous five years had been used. In other words, the discretionary cost was about $1,330 more for every recipient. As a result, the fund has accelerated that much faster toward a deficit position (Exhibit 8.5).

8.66 We are concerned that there is no documentary evidence that the Minister had been adequately briefed on the financial implications of using the higher current figure of $60,000 for each of the previous five years. There was also no delegation of authority from the Minister authorizing departmental officials to exercise the discretion permitted the Minister in the legislation.

8.67 **Analysis.** In our opinion, the Administration should have better information on trends and external influences so it can predict and react to events that might compromise the fund. The combined effect of introducing the new payout formula and the method of calculating averages increased payouts by at least $280 million. If such amounts had not been disbursed, the fund would be in a stronger position to respond to current needs.

Exhibit 8.5

BALANCE OF THE WESTERN GRAIN STABILIZATION FUND AT 31 JULY 1976-1986



The financial viability of the fund is in doubt.

8.68 **The Department of Agriculture should, as a matter of urgency:**

- **carry out a detailed review of all aspects of the Western Grain Stabilization Administration from the viewpoint of its financial viability; and**

- **brief the Minister fully on the financial implications of its interpretation of the method of calculating the stabilization payments to be made under the Western Grain Stabilization Act and obtain specific approval to use this or any other interpretation.**

Department's response: *As stated in the Government response to the recommendations of the Standing Committee on Agriculture, the Department will review all aspects of the program, by December 1986. The review will also address the issue of the formal briefing of the Minister on the financial implications of the interpretation of the method of the calculation of the stabilization payments and the obtaining of specific approval for the method used.*

Crop Insurance

8.69 **Program overview.** Crop Insurance is a federal-provincial program designed to stabilize farm income by providing insurance protection for farmers against crop losses resulting from drought, insect infestation or other natural production hazards. For each insured crop, the farmer is guaranteed a level of coverage related to past yields. If production falls below the guarantee, which is converted to dollars by assigning a price per unit of production, the farmer can claim the difference. The value of the farmer's claim, then, depends on the price option chosen at the time the insurance policy was issued.

8.70 Under the Crop Insurance Act, passed in 1959, the Minister of Agriculture has the authority, with the approval of the Governor in Council, to enter into federal-provincial agreements covering crop insurance plans that are administered by the provinces. The Act requires that every insurance plan be self-sustaining.

8.71 There are some 216 plans in operation in the 10 provinces, covering most commercial crops. The federal government has two cost-sharing options. It can either provide up to 25 per cent of the total insurance premium and half of the province's administrative costs (as in agreements with Quebec and Newfoundland) or up to 50 per cent of the total premium (as in the other eight provinces). The farmers pay 50 per cent of the premium in both cases.

8.72 The cost of the federal contribution depends on farmer participation levels, amount of crops and acreage insured, premium rates and insurance coverage levels. The province's delivery of the program has a direct effect on these factors.

8.73 For 1985-86, approximately 126,000 farmers bought $4 billion in coverage. From the program's inception in 1959 to 31 March 1986, cumulative claim payments totalled some $3 billion. Premium income, including the federal share, totalled $2.7 billion, resulting in an accumulated deficit of $261 million. The federal government's contribution to date has been $1.3 billion (Exhibit 8.6). For 1985-86, there was a deficit of approximately $326 million. The federal contribution in 1985-86 was $198 million.

8.74 **Audit scope.** We focused on the federal role in managing the Crop Insurance program. We reviewed, on a test basis, the agreements with Alberta, Saskatchewan, Manitoba and Ontario. These provinces have 83 per cent of participating farmers and received 92 per cent of the cumulative federal contribution to 1985-86.

8.75 **Premium rate levels.** The provinces propose premium rates annually for each plan, and the Crop Insurance Division approves these for ultimate inclusion in the agreements. We found that the Division had not sufficiently examined proposed premium rates. The Division has informed us that this was due to a lack of resources. Also, it has not obtained an actuarial opinion on whether the premium rates were set at an appropriate level to make the plans self-sustaining and actuarially sound. We believe such a study is necessary. Our actuarial review indicated that fundamental procedures necessary for a self-sustaining insurance plan, such as maintaining adequate reserves for unforeseen losses and fully assessing risk by recognizing long-term expected claims experience, were not being adequately followed.

Exhibit 8.6

CUMULATIVE CROP INSURANCE EXPERIENCE - INCEPTION TO 1985-86

($ 000)

	Premiums Paid In	Claims Paid Out	Surplus (Deficiency)	Federal Contribution to Crop Insurance Plans
British Columbia	$ 54,156	$ 65,007	$ (10,851)	$ 25,914
Alberta	769,945	867,276	(97,331)	356,204
Saskatchewan	1,083,973	1,303,263	(219,290)	521,196
Manitoba	280,675	247,446	33,229	131,856
Ontario	312,816	299,142	13,674	168,216
Quebec	142,470	121,994	20,476	65,749
New Brunswick	10,507	13,444	(2,937)	4,938
Nova Scotia	5,451	3,205	2,246	2,117
Prince Edward Island	23,202	23,356	(154)	9,623
Newfoundland	182	168	14	238
Totals	$ 2,683,377	$ 2,944,301	$ (260,924)	$ 1,286,051

▨ Agreements that were audited. 1985-86 data are preliminary.

8.76 The cumulative deficit of $261 million reinforces our concerns. The federal government will be required to advance funds for the first time. This will be on an interest-free basis, and will amount to some $175 million for two provincial insurance programs. These advances will be repaid by premium receipts from farmers and the federal government.

8.77 **Reserve provisions**. An integral component of premium rate setting is building reserves for years when claims exceed premiums. If adequate reserves are not built up, participating farmers may not be able to pay the very high "self-sustaining" premium rates that would be needed after a series of bad years when a deficit has to be recovered. The amount of reserve required may be quantified by examining the variability (standard deviation) of the crop's yield. For crops that have wide yield fluctuations, larger reserves are needed. If there were an appropriate accumulated surplus from prior years, the rates could be lowered.

8.78 Although the Division recognizes that reserves are necessary, its current procedures do not set a reserve target related to the variability of the crop's yield. For example, Saskatchewan's reserve levels are three times the annual premium, and Ontario adds 10 per cent to its basic premium for catastrophes and unknowns. In years of severe losses these have proved to be insufficient to cover losses.

8.79 **Claims experience**. A thorough risk assessment requires that both past and predicted crop yield experience be considered in estimating long-term expected claims. Currently, premium rates are based primarily on past claims experience. This is not entirely appropriate because it forecasts that the future will be identical to the past. But to estimate how far past results are applicable to future periods and determine how recent developments such as soil degradation and new technology may affect future claims and premium rates, actuarial input is also needed.

8.80 **Premium rate setting practices.** A rate setting method developed in 1965 by the Department of Insurance as a long-term basis for Crop Insurance premium calculation is being modified by the use of past experience only, largely because of administrative economy. We believe the use of actual experience only is risky and may not provide a cushion against unforeseen losses. Recent calculations by the Division on a limited number of plans with both high and low yield variability indicate that premium rates determined by past experience are, on average, about 20 per cent below what they would be based on the application of the Department of Insurance method.

8.81 Also, the present practice of annual premium revision, which is not recommended by the Department of Insurance as a general principle, imposes a heavy workload. Less frequent revision would permit, with the same resources, a more detailed analysis of the data, the rates and recent trends.

8.82 The Division has recently obtained additional staff to improve its review procedures and is also in the process of converting to a computerized data storage system, which will provide timely management information and greatly facilitate regular actuarial review.

8.83 **In amending its rate setting procedures, the Crop Insurance Division should define what constitutes a self-sustaining insurance plan, make provision for adequate reserve funds, and analyse future trends as well as past experience to estimate long-term expected claims.**

> Department's response: *The Department agrees. A project was established in April 1986, for completion by December 1987, to continue to work closely with the Department of Insurance to improve the rate setting methodology, including:*
>
> *i) more clearly defining what constitutes a self-sustaining plan, including criteria, by April 1987;*
>
> *ii) on the basis of (i) above, making provision for adequate reserve funds and ensuring that future trends, as well as past experience are taken into account in estimating long-term expected claims, by September 1987; and*
>
> *iii) negotiating with the Provinces changes and/or refinements of procedures and processes, where necessary, by December 1987.*

8.84 The Crop Insurance Division should review the appropriateness of its rates every two or three years, on the basis of a formal actuarial review of its insurance plans.

> *Department's response: The Department agrees and, in connection with the previous recommendation, a plan will be developed for implementation by December 1987.*

8.85 **Information to the Minister and the Governor in Council.** The Crop Insurance Act requires that premium rates be self-sustaining "in the opinion of the Governor in Council" and that federal-provincial agreements be amended to provide for this with the consent of the Minister. We found no evidence that information on actuarial soundness was being provided to the Minister or the Governor in Council, even for the largest insurance plans, to facilitate the making of informed decisions.

8.86 While the Division provides the Minister with documentation on specific provincial proposals, and the Minister and the Governor in Council with explanatory information listing the crops for which premium rates are being revised, together with the rates, no actuarial or management opinion is provided on whether plans are self-sustaining and actuarially sound.

8.87 The process of amending federal-provincial agreements is cumbersome and subject to significant delays. As a result, amendments have been made without the prior consent of the Minister, and federal funds have been advanced at the amended rates on the basis of departmental approval. Such advances were made in "good faith" on the assumption that the amendments would be signed by all parties.

8.88 Ministerial consent for 1984-85 program changes was not obtained until 3 weeks to 17 months after insurance contracts were marketed and sold provincially and from 5 to 23 months after the Division had written to the provinces approving the proposed amendments.

8.89 The Crop Insurance Division should provide complete information, with an opinion, to the Minister and Governor in Council on whether insurance plans are self-sustaining and actuarially sound. Where they are not, it should make recommendations on what is required to re-establish self-sufficiency, at least for the largest plans.

> *Department's response: The Department agrees and, following implementation of recommendations 8.83 and 8.84, will provide the required information.*

8.90 The Department of Agriculture should examine options for expediting the process of amending federal-provincial agreements so ministerial consent can be obtained before new rates and prices are marketed.

Department's response: Letters to this effect have now been sent to the Provinces, requesting that agreements for 1987-88 be signed by April 1, 1987. In addition, the Department is currently examining other options that might further expedite the process.

8.91 **Due regard for economy.** A 1973 amendment to the Crop Insurance Act provided the option whereby the federal government could pay its share of costs by contributing up to 50 per cent of total premiums, with the farmer paying the other 50 per cent and the province paying the costs of administering the plan. Since 1973, the federal share, in relation to that of the provinces, has risen steadily. In 1973-74, the federal-provincial division of total program costs was 2.7 to 1. By 1984-85 it had increased to 4.9 to 1. We found no evidence that the Division analysed this trend and brought it to the Minister's attention with recommendations for action. The Division is, however, currently negotiating with the provinces to reduce the federal share in response to a concern expressed by the Nielsen Task Force on Program Review.

8.92 **Information to Parliament**. Effectiveness information on the Crop Insurance program was not reported to Parliament in Part III of the Estimates or in the Division's annual reports. The Division has not developed a complete set of performance indicators. As a result, Parliament has not been told whether the program has met its objectives, or whether the various insurance plans are self-sustaining.

8.93 **Performance indicators should be developed by the Crop Insurance Division and the results of using them should be reported to Parliament, with details on the degree of self-sufficiency of current crop insurance plans.**

Department's response: The Department will further refine its performance indicators to include details on the degree of self-sufficiency of crop insurance plans, as part of its future Operational Plans. The result of applying these effectiveness measures will be made available to Parliament.

Research Branch

8.94 The Research Branch is responsible for maintaining and improving the productivity of the agri-food sector through developing and transferring new knowledge and technology. This responsibility is contained in the Experimental Farm Stations Act of 1886.

8.95 The scope of the Department's research is very broad, relating to most animal, crop and food production in Canadian agriculture. It ranges from direct support of farmers' needs and direct contact with them, to sophisticated research in biotechnology and genetic engineering. In addition, national data bases are maintained and developed on agricultural soils, water resources, biological species and plant diseases.

8.96 The Research Branch operates 43 major research establishments and 15 experimental farms and sub-stations across Canada. Each is independently managed within its allocated budget and person-years. There are two types of establishments:

research institutes and research stations. The institutes, which are located in Ottawa, carry out research with a national scope. Research stations are located in agricultural areas to develop and implement mission-oriented applied research programs that serve regional needs. They are also required to contribute to national objectives and goals of the Research Branch and the Department of Agriculture.

8.97 The Research Branch has seven regional and national administrative divisions. Its administrative structure is characterized by extensive decentralization and a high degree of autonomy for each of the research establishments.

Management of Research Operations

8.98 **The research environment.** This is the centennial year for agricultural research in Canada. Since it established the first experimental farm in 1886, the Department of Agriculture has made major contributions to improving the quality and quantity of food supply in Canada, so that it not only meets domestic needs but significantly contributes to export earnings.

8.99 The Nielsen Task Force's recent report recommended that the Research Branch adopt market-oriented, commodity-based development strategies. It noted the absence of an integrated commodities strategy for agricultural research, and identified the clear need to focus on development. If the Task Force recommendations are implemented, they could have a profound effect on the Branch's organizational structure and future direction.

8.100 The diversity of Canadian climate, soils, crops, ecology and markets makes agricultural research complex and requires that regional initiatives be coupled with a national program. However, although Agriculture Canada's scientific research and development (R&D) program is structured and planned by program objectives, its organizational structure is extensively decentralized and autonomous, and resources are allocated by regions and controlled at the level of the establishments. We believe that the ambiguity and strains inherent in the relationship between the requirement for a national R&D program and the decentralized organizational structure were a source of the problems we observed during our audit.

8.101 Because the research stations are highly decentralized, they can respond quickly to local agricultural emergencies, such as pests, drought and environmental concerns. This advantage is offset by certain drawbacks. There is considerable external pressure to develop research priorities and programs and to conduct research in all geographic regions, in all commodities and in all disciplines.

8.102 In our opinion, and as discussed in subsequent paragraphs, Branch headquarters needs to improve on its corporate management role and provide greater national direction if there is to be an improvement in the management of research operations in the Branch as a whole. We believe this does not need to result in more person-years or administrative costs.

8.103 **Follow-up on previous audits.** In 1981, we audited the Research and Development function in Agriculture Canada as part of our government-wide study of R&D programs in federal government departments. In 1982 this Office conducted a comprehensive audit of the Department of Agriculture which included the Research Branch in its scope. It concentrated on the integration of research planning, control and evaluation systems with departmental systems, and changes in research management systems since the previous audit.

8.104 The Department's follow-up report to the Standing Committee on Public Accounts dated July 1985 indicated that substantially all our 1982 recommendations had been accepted and implemented. However, although the Research Branch has developed a large number of new initiatives to improve all facets of planning, operations and review, we found that many of these have not been completed, few have been implemented and even fewer are actually being used by program managers.

8.105 We are concerned with the lack of urgency displayed by the Research Branch in implementing the recommendations we made in 1981 and 1982. The Branch's draft 1986-1990 Operational Plan (March 1986) has added to our concern. It states that the plan provides a bridge between the old planning system and the new planning process; that is, that current plans will be pushed into the time frame of the new plan. The specific target dates for each of the major thrusts of this plan range from 1986 to 1990. This means that tangible response to some of our 1982 audit recommendations may not be completed until 1990 (for example, the Branch Decision Information Systems Project).

8.106 **Planning and resource allocation.** The Branch's R&D objectives, whether at the strategic or operational level, are not used as the primary means of structuring and co-ordinating agricultural research. Nor are they used in setting goals and allocating resources for the different levels, or as a basis for evaluating research program effectiveness. Objectives are not specific or expressed in results-oriented terms that would permit measuring or evaluating the degree of achievement. Many are ambiguous because they relate to research programs described as multi-establishment development programs across Canada, when, in fact, research is generally conducted at particular establishments.

8.107 Also, although there is extensive contact between the staff at Research Branch headquarters and its clients, there is no evidence that this is used in strategic planning to identify client needs or to provide for client participation in the development of research programs. Contact with other federal and provincial research departments, universities and some industries is provided through the Canadian Agriculture Services Co-ordinating Committee and the Canadian Agriculture Research Committee. Most of their meetings focus on short-term operational concerns and do not address strategic research concerns, objectives or priorities. Two recent studies did address these issues, but the Branch did not act on any of their recommendations. We were not able to determine the reasons for this.

8.108 Agricultural research programs are, in practice, largely determined at the research station and institute level. The directors of research establishments translate general strategic direction from the Assistant Deputy Minister into research programs, provided they are within their establishment's approved program structure. Each establishment has its own network of formal and informal contacts with provincial governments, growers, processors and academics that influences both the source and selection of proposals for research, in addition to internal review procedures.

8.109 We reviewed the procedures used by the establishments for client consultation, research needs identification, planning, priority setting and resource allocation and found them to be satisfactory. Each establishment is thus successfully developing and implementing research programs to conduct "mission-oriented" research to serve the objectives of its own specific regional needs, within the general planning framework.

8.110 We are concerned, however, that there is no adequate complementary guidance and direction from Branch headquarters. This is necessary if overall agricultural research thrusts and objectives are to be clearly identified for the benefit of establishments. Aggregating establishment research projects to the regional or national levels for planning systems purposes is not enough. It does not ensure that research projects are relevant to the objectives and goals of the Research Branch and the Department. Also, it does not allow the Branch to direct and focus appropriate resources on high priority research topics.

8.111 The Branch's planning objectives include, as one of two key elements, a technology transfer function. We found no definition of the term "technology transfer", or delineation of the roles to be played by the Branch, the provinces, the establishments and industry. Furthermore, we found existing mechanisms for technology transfer to be weak, and exercised independently by research project leaders at the research establishment level.

8.112 The Branch has included many projects, with specific completion dates, for improving its strategic and operational planning and improving the priority-setting and resource allocation processes in the Operational Plan. However, we are concerned about its past implementation record. We will follow up on the Branch's progress in completing these projects by 31 March 1988 to determine whether it has actually implemented its many proposed improvements.

8.113 **Management direction to research establishments.** A major function of Research Branch headquarters is to provide the administrative infrastructure for meeting financial, planning and other requirements of the Department and central agencies. However, the Branch is weak in providing effective corporate management direction to research establishments for the management of research program delivery.

8.114 **Preparing, planning and selecting proposals**. Branch-wide guidelines have been only partially developed. Guidelines for preparing, planning and selecting project proposals would help to ensure that the approach and methodology are appropriate, that planned resources will achieve the desired results within the estimated time, and that facilities, equipment and staff are available for the work. The beneficiaries of the R&D should also be identified.

8.115 In response to our 1981 and 1982 audit recommendations that there should be formal project preparation, planning and selection procedures and criteria, the Branch stated that it would review the 1984 Comptroller General's guidelines, adapt them if necessary, and have them approved and implemented throughout the Branch. This has not been done.

8.116 However, the Branch continues to accept the importance of having formal guidelines and has included a project in the Draft Operational Plan to develop guidelines by September 1986. We will follow up on the Branch's completion and implementation of this project by 31 March 1988.

8.117 **Project implementation and control**. Branch-wide guidelines for project control, describing the appropriate points at which assessment of scientific progress is to be made in relation to time and resources expended, are limited to the documentation required for the annual project report. They do not cover criteria to be applied during project implementation for expanding, extending, or terminating ongoing projects by research establishment Directors.

8.118 The Research Branch's Project Inventory System, used by all establishments, is essentially a cataloguing of all research projects through a central computer. It provides Research Branch information for the Inventory of Canadian Agricultural Research (ICAR), a computerized data information system. However, the system has not been kept up to date.

8.119 Financial information is limited to the total estimated project costs, in terms of professional person-years. There is no system for monitoring actual project costs. Furthermore, expenditure and commitments are controlled against the total establishment and not the project budget.

8.120 At the Branch level, a pilot project was started in 1984 to link financial and operational planning and control in the context of the Operational Plan Framework. However, this was not extended to other levels, and work on it has been suspended. It has been superseded by a revised action plan for implementing operational control at successive levels of Branch management by 1990. We will follow up on the Branch's progress by 31 March 1988.

8.121 **The Research Branch should ensure that, as a matter of urgency, it implements its identified initiatives covering the recommendations we made in 1981 and 1982 and clarifies Branch research objectives. It should also develop procedures in respect of technology transfer, priority setting and resource allocation, and management direction to research establishments.**

Department's response: The Department agrees that, by December 31, 1987, it will:

- *complete the implementation of recommendations made in the 1981 and 1982 Auditor General Reports;*

- *consistent with the market-oriented commodity-based development strategies, review and clarify Research Branch objectives; and*

- *develop and implement procedures for technology transfer, priority setting and resource reallocation, as well as reviewing its management systems for the provision of direction to Research establishments and putting into place any required changes.*

8.122 **Review and evaluation.** We found the existing departmental procedures for program evaluation and internal audit satisfactory, to the extent that they were applied within the Research Branch.

8.123 We also assessed the National Program Reviews – an important forum for client consultation by Branch headquarters – for swine, beef and dairy and found the methodology to be satisfactory. Since these reviews include participants from provincial and federal government departments, growers, processors and academics, they not only evaluate existing research activity but could be used to change the focus of research activity content, direction and location.

8.124 However, a major drawback of the studies conducted so far is that they do not appear to consider the possible effects of trade-offs among research priorities, research program objectives and resources. For example, in the animal productivity area there is no analysis of trade-offs among beef, dairy and swine research programs. Also, we found no evidence that the Branch has acted on the action plans arising out of the reviews; for example, on the National Beef Program Research Review.

8.125 Performance indicators developed for the Operational Plan suffer from serious conceptual, measurement and attribution problems. More important, they are not being used to measure the efficiency and effectiveness of Branch operations. The Branch has recognized these shortcomings and has plans to use different performance indicators to measure achievement of its 1986-87 Branch operational goals.

Management of Major Capital Projects

8.126 Our examination of the management of major capital projects comprised two projects involving construction and one in respect of leasing research facilities. We had concerns in respect of two of these projects, summarized below.

8.127 **London Research Centre.** The Centre was established in 1951 at the University of Western Ontario to investigate national problems arising from the use of pesticides for crop protection. In 1966 the program was expanded to include a soil pesticides section.

8.128 A project to build a new facility, at a cost of $14 million, to replace existing facilities at Richmond Street in London, Ontario, began in 1981. Thirty-six sites were considered, and a short list of four selected. These sites were evaluated on the basis of soil type and topography, absence of pesticide residues, availability of services, location and accessibility.

Site Appraisals

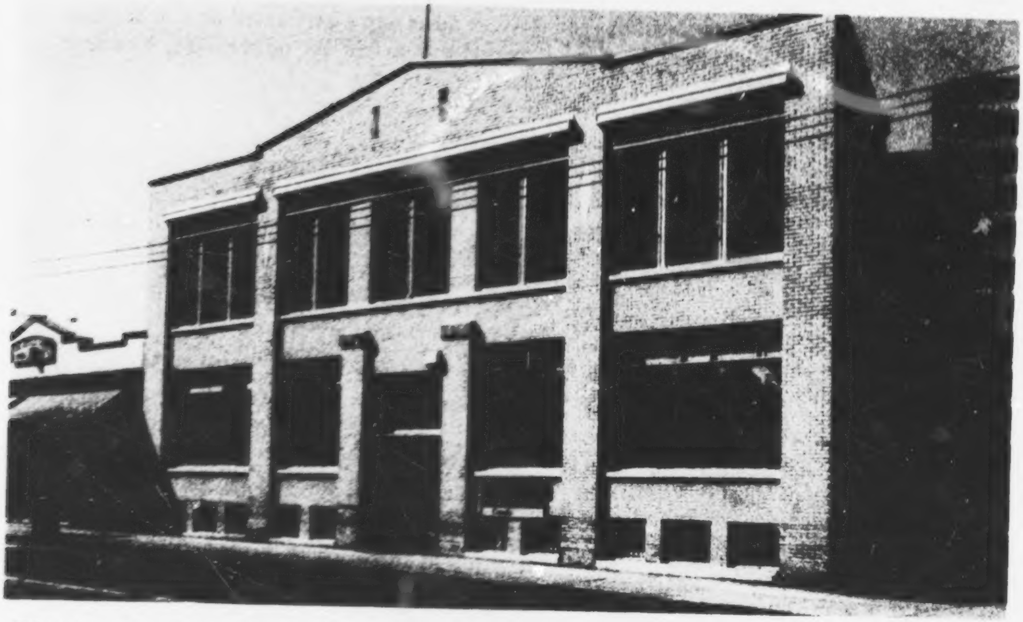
Site	Approximate Asking Price	Appraised Value	Acreage
A	$ 839,800	$ 435,000	67
B	945,000	945,000	25
C	950,000	950,000	25
D	300,000	200,000	25

8.129 Three of the sites were approximately 25 acres in size, and met most of the requirements. The fourth site (site A) of 67 acres, was purchased at the asking price of $839,800, about $405,000 more than the appraised value. The appraiser assessed the value of five of the acres at $25,000 per acre because they were within the city limits and could be serviced; although the asking price was $20,000 per acre. But the balance of 62 acres outside the city limits was appraised at $5,000 an acre – the established rate for township land. The Department paid about $12,000 per acre for the township site. Negotiations did not appear to take into account the lower value of the land in the township.

8.130 The Project Definition Report indicated land requirements of 21.5 acres. The Department's purchase of 67 acres was well in excess of its current needs. At an average cost of about $12,000 per acre, the Department paid about $546,000 for the portion of the land that was beyond its requirements (in itself in excess of market value by $7,000 an acre). We were told that the total land requirement covered future expansion, and provided isolation. We were unable to obtain documentation supporting either of these claims.

8.131 The Treasury Board approved the proposal for the land acquisition but directed that four matters be clarified for the record. We have been advised that Treasury Board did not receive an appropriate response to the four questions raised.

8.132 **Richmond Street Annex lease.** The lease on the existing laboratory ended in 1982 with a one-year renewal option. We were informed by departmental officials that, in 1983, the lessor requested a 10-year lease renewal at an annual cost of $50,000, which was deemed not to be feasible by the Department of Public Works because the new research facility would be ready by 1987. The lessor then leased it to another company which sublet it for five years to Public Works at an increase of 600 per cent (the annual cost increased from $26,400 to $163,000). This was $315,000 more than the cost of the 10-year lease initially proposed by the lessor.



The Department paid $163,000 a year for the past 5 years to lease this building in London, Ontario, when it might have paid $50,000 a year for a 10 year lease. The total additional cost over 5 years will be $315,000 (see paragraph 8.132).

8.133 **The Department of Agriculture should ensure that its facilities are acquired and its leases arranged with due regard for economy.**

> *Department's response: The Department agrees and procedures in this regard will be reviewed, modified where necessary, and implemented by March 31, 1987.*

Management of Human Resources

8.134 We reviewed progress on our 1982 recommendations in respect of human resource management in the Research Branch. Implementation of the recommendations on human resource management in other branches will be reported in 1988.

8.135 **Resourcing strategies.** We observed in 1982 that the Department needed to define its staff requirements more precisely and develop specific programs to influence hiring. We recommended that it evaluate options for meeting skill shortages, and the Department indicated agreement and advised us subsequently that the recommendation had been implemented.

8.136 However we found that the Branch has continued to follow its 1982 strategy of recruiting approximately half its scientific staff at lower levels than required for research activity and granting paid leave to allow them to complete post-graduate studies. An alternative proposal has been assessed and is considered to be cost-effective, but no decision has been taken on it.

8.137 There is still no strategic plan for key occupational groups such as research scientists, although the need for such a plan has been acknowledged since 1982. Out of a population of 894 research scientists, 159 or 18 per cent are in a position to retire over the course of the next year. Twenty-eight per cent of the research scientists in the Branch are 55 years or older, 60 per cent are 45 or older, and only 24 per cent are under the age of 40.

8.138 The Branch's turnover rate for research scientists has dropped to 3 per cent against the departmental average of 6.4 per cent, which makes its problem of ensuring an adequate supply of relevant research skills easier. However, this should not stand in the way of assessing the demand for key occupational groups, costing resourcing options and evaluating human resource strategies regularly in relation to funding priorities. Without this information, management does not know whether it is ensuring continuing research capabilities or whether it is planning and managing its resources effectively to meet changing priorities and technology.

8.139 **Integration of human resource and operational planning.** The Department agreed with our 1982 recommendation to do this, and later indicated that implementation had been completed by December 1983. The planning process now calls for integration but this has not been achieved. Human resource and operational plans are still prepared as two separate exercises. The Research Branch contributes to this problem by not submitting enough planning information to Personnel, such as its plans for handling workforce adjustment. The result is that neither Branch nor corporate needs relative to workforce adjustment support can be properly assessed.

8.140 Human resource management has not been given a high priority and no accountability framework has been developed for it. In the circumstances, our 1982 recommendations, with few changes, continue to be valid and we are making them again.

8.141 **The Department of Agriculture should:**

- **develop and communicate a corporate policy, objectives and approach with respect to the management of its key occupational groups such as research scientists;**
- **periodically evaluate options to meet future research requirements as defined in the Operational Plan to ensure that resourcing strategies are cost-effective and reflect a commitment to the best development and use of existing resources; and**
- **integrate its human resources planning with operational planning and with other personnel systems.**

Department's response: *The Department considers that the management of human resources must be a high priority, and will ensure that its Human Resource Plans are linked with Operational Plans. The Department will:*

- *develop a corporate policy with respect to the management of key occupational groups, by March 31, 1987;*

- *develop a plan to ensure that resourcing strategies are cost effective as well as reflecting a commitment to the most effective use of existing resources, by March 31, 1987; and*
- *develop a five-year Human Resource plan for Research Branch by December 31, 1986.*

Marketing and Economics Branch

8.142 The Marketing and Economics Branch is responsible for improving the efficiency and effectiveness of both domestic and international markets for Canadian products through stimulation of, and assistance to, the agri-food sector. It has an important role in encouraging the use of Canadian food products at home and abroad, assisting co-operatives and producer organizations, and operating marketing, processing and distribution assistance programs. Because the domestic market is fairly stable, limited growth is anticipated, and the world market is recognized as the primary source of increased demand.

Planning and Control

8.143 As with the other branches we reviewed, we noted that the strategic planning process in the Marketing and Economics Branch is weak, and that the Branch's relationships within the Department are not clearly defined. There are four separate policy development groups and a central co-ordination unit. Uncertainties about roles and responsibilities may result in duplicated effort.

8.144 Also, we found that the Branch has no measurable goals. While we recognize that establishing objective, measurable goals is difficult in areas such as economic and policy analysis, without them managers cannot establish priorities. As a result, the Branch reacts to problems rather than assigning resources where they will be most effective.

8.145 Also, for program delivery to be effective, potential users must be advised of the services that are available. When asked what program information the Branch could give a corporation seeking assistance, we were provided with a 1982 brochure that is now out of print.

8.146 **The Marketing and Economics Branch should clearly define its mandate and establish objective, measurable goals and long-term and short-term plans to reach them.**

Department's response: Refer to paragraph 8.153.

Market-oriented Research

8.147 The fundamental objective of the Branch is to improve the efficiency and effectiveness of both domestic and international markets for Canadian products. We would therefore expect it to identify specific areas where markets are inefficient or ineffective and the causes for such performance. The Branch could then identify goals and develop and evaluate alternatives for improving market performance. Very little research, however, is conducted for this purpose or for determining the effectiveness of current policy in improving market performance.

8.148 The Branch could, for example, analyse alternative markets where current markets are declining, identify food product needs and ways of meeting them, determine the regional and other effects of stabilization programs and ways to improve them, and analyse the potential effects of options, by commodities and regions, for international trade policies.

Need to Improve Performance Indicators

8.149 Improving the efficiency and effectiveness of domestic and international markets has been described in the Branch's operational planning framework as having several desired effects, with indicators of efficiency and effectiveness for each.

8.150 These indicators have the serious flaw that they do not measure the contribution of the Branch to its objectives. They may be indicators of the agricultural sector's performance, but not of the Branch's contribution to that performance. For example, the Canadian market share of a commodity can be affected by the weather, the price, foreign countries' policies, Canadian policy, changes in transport costs, or changes in production costs, as well as by the Branch's efforts. Therefore, it is difficult to see how this indicator can be useful to management in allocating resources, planning programs or evaluating effectiveness.

8.151 Many of the indicators, even as measures of performance for agriculture, also have conceptual problems. For example, the output per person in the food processing and distribution system may increase because of the substitution of capital (machinery and equipment) for labour. But if, as a result, output per unit of capital declines, it is not at all clear that efficiency or effectiveness has improved. Furthermore, several of the indicators cannot be measured – for example, how can "world-class products" be identified?

8.152 We also reviewed the indicators in respect to the Branch's sub-objectives and found them lacking in precision and attribution or weighted toward relatively insignificant portions of the Branch's operations.

8.153 **The Marketing and Economics Branch should develop performance indicators, where possible, that measure the contribution of programs to their goals and objectives, and should use them to monitor its performance.**

Department's response: As indicated in the departmental response to recommendation 8.46, the reorganization of the Department in July 1986 affects, in a major way, the operations previously carried out in the Marketing and Economics Branch. The reorganization will enable the Department to more effectively combine and link the Department's analytical and policy capabilities.

Prairie Farm Rehabilitation Administration

8.154 The Prairie Farm Rehabilitation Administration (PFRA), estimates that its 1986-87 expenditures will be approximately $165 million, substantially for four programs in respect of rural water development, community pastures, emergency drought assistance and subsidiary agreements.

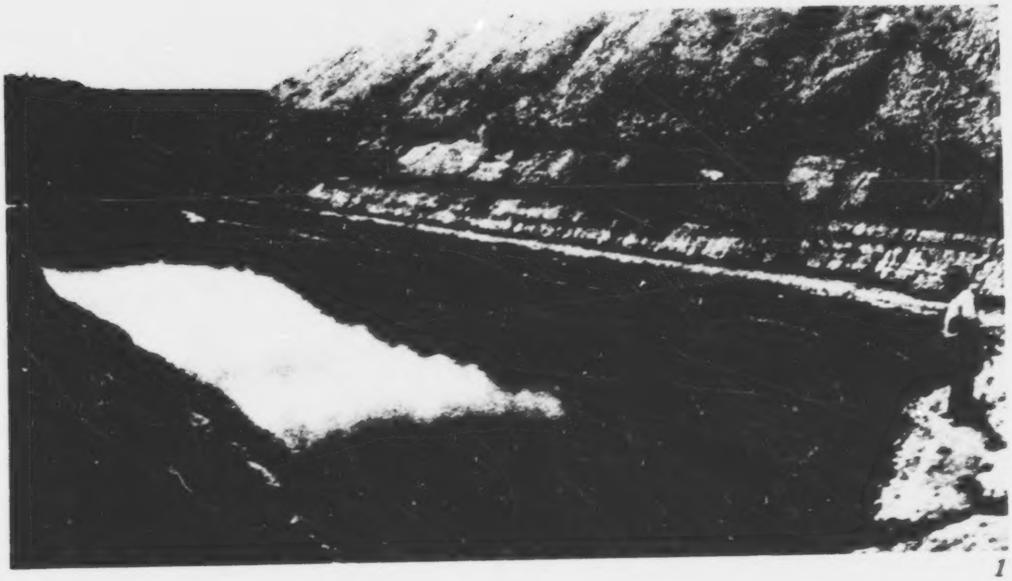
Rural Water Development

8.155 This program was among the first introduced after passage of the Prairie Farm Rehabilitation Act in 1935, to assist in the development of dependable rural water supplies, reduce vulnerability to drought, and support economic stability and growth in the prairies. Financial and technical assistance is provided to individuals, groups of farmers or ranchers, and communities with populations of under 300 for well drilling, dugouts, stock-watering dams, irrigation projects and community developments. One of PFRA's objectives is to enable recipients of its water development services to withstand two years of drought conditions.

8.156 During 1985-86, the Department allocated $6.1 million to assisting approximately 6,000 projects financially and 1,650 projects technically. The program is not guided by either local or regional strategic plans; instead, it reacts to demand.

8.157 **Planning.** We expected to find that, as a basis for its short-term and long-term water conservation and development plans, the Administration would set specific and measurable program objectives, define needs and reliable sources of water, consider possible solutions, at least by region, and estimate the extent to which problems could be solved at different funding levels. During our review of program planning documentation, we noted that PFRA has not yet defined:

- rural water development needs in the prairie provinces;
- the proportion of these needs to be addressed by PFRA programs and the length of time it will take to address them;
- the extent to which programs (for example, wells, irrigation projects, and so on) will reduce vulnerability to drought or improve the productive capacity of land and livestock;
- linkages with other federal and provincial programs such as Crop Insurance and emergency assistance to, for example, help in identifying drought affected areas; and



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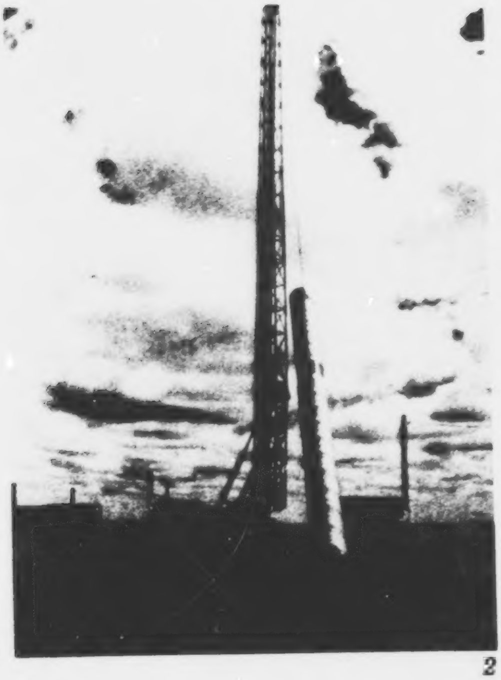

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1. Dugouts like this have not always held enough reserves to cope with drought conditions on the prairies. 2. Well-digging in Saskatchewan. A large portion of PFRA well drilling resources has been put into shallow wells across the prairie provinces which are highly vulnerable to drought conditions. 3. This area of southern Saskatchewan is one of many devastated by the recent prolonged drought. Vulnerability to even a one-year drought remains a major problem in many areas on the prairies (see paragraphs 8.155 to 8.162).

- comprehensive systems or measures to assess the economy, efficiency or effectiveness of each program and PFRA as a whole.

8.158 At present, the rural water development program largely reacts to demand. Annual funding is based on precedent, adjusted for current applications, for the various services. PFRA has not, until very recently, attempted to focus its allocation of funds on specific local or regional water development strategies; funds are disbursed throughout the prairies rather than in selected areas to facilitate the resolution of specific problems.

8.159 **Performance measurement.** PFRA has only partially determined and analysed the benefits and costs of the program and has not yet developed appropriate performance indicators. Current performance indicators address basic requirements such as number, type, location and value of contributions. As measures of efficiency and effectiveness, these need to be improved to provide managers with meaningful information on the manner and degree to which program objectives are being met.

8.160 In March 1981, a PFRA submission to the Treasury Board, seeking increases in the size of water development contributions, noted that 90 per cent of farmers did not have adequate water supplies to withstand a one-year drought. This, together with the preliminary results of other PFRA studies, indicates that the rural water development programs, while providing a measure of assistance, are not significantly reducing vulnerability to drought.

8.161 Our review of PFRA and other recent studies indicate there is a need to reassess program funding strategies and consider alternative projects. For example, the current funding structure tends to encourage shallow wells which are vulnerable to drought, rather than deep wells or alternative structures that are less vulnerable. In the drought years of 1977, 1980 and 1984, 71 to 81 per cent of PFRA-supported wells were shallow. A PFRA study in Manitoba, for example, indicates that current dugout structures are vulnerable to even moderate drought conditions. In Alberta, for example, failures of wells, dugouts, and stock watering dams were widespread during the drought years of 1984 and 1985. Combined with the absence of viable forage insurance programs, this has led to costly emergency water and feed supply assistance programs sponsored by federal and provincial governments. Since 1977, total emergency assistance to drought-affected areas has approximated $450 million.

8.162 These observations illustrate the need for water development strategies that are not only sensitive to local needs but also establish long-term, cost-effective solutions. Alternatives such as strategically located permanent water supplies, water pipelines and recycling, which may offer long-term solutions, are now being explored by PFRA and the provinces. What remains to be done is for PFRA and the provinces to analyse the costs and benefits of these and other alternatives, which may offer longer-term solutions.

8.163 **The Prairie Farm Rehabilitation Administration should conduct a comprehensive analysis of rural water development needs, alternatives and priorities for providing long-term, cost-effective relief. The Administration should**

also develop specific performance indicators and a schedule of program evaluations so it can assess its current activities in relation to these needs.

> *Department's response: The Prairie Farm Rehabilitation Administration has completed a comprehensive analysis of water availability, distance to source and relative security of supplies for the Province of Alberta with similar studies presently underway in Manitoba and Saskatchewan. Phase II studies to assess future source options will begin by Fall 1986. Prairie Farm Rehabilitation Administration will develop appropriate performance indicators and will:*
>
> - *complete Drought Sensitivity and Water Sourcing studies planned for 1986-87; and*
> - *undertake program evaluations with a progress report to be provided by June 30, 1987 with evaluations to be completed by March 31, 1988.*

Community Pastures

8.164 Introduced in 1937, the community pastures program was designed to remove marginal and unsuitable lands from crop production and keep them in permanent grass cover. Land was obtained through federal Crown holdings and lease agreements with Saskatchewan and Manitoba, grassed and fenced, and offered to farmers for pasture. Breeding services were established, and a pasture management structure put in place.

8.165 In 1985-86, PFRA operated 88 pastures on 912,000 hectares (2.3 million acres) in Saskatchewan and Manitoba and on the Suffield Military Range in Alberta. Pasture staff (180 person-years) handled 217,000 cattle belonging to over 4,100 owners. PFRA provided 2,280 bulls for breeding purposes and rented an additional 1,050 bulls from farmers. The total cost of pasture operations was some $12.1 million of which about $3.2 million was allocated to pasture land conservation. Grazing and breeding costs are expected by the Treasury Board to be recovered from patrons. PFRA letters to patrons indicate that there have been annual deficits in every year from 1980 to 1985. We have been advised that these deficits were calculated in error but that efforts are continuing to reduce costs and to recover all costs through fees. A PFRA study, however, expresses some concern that a reduction of costs may be achieved at the risk of deferring pasture maintenance and upgrading expenditures.

8.166 **Management improvement opportunities.** We found that the pastures were managed by experienced staff, and that information management systems provided appropriate, accurate and timely data to facilitate key decisions on planning and operations. However, current management practices were not always the most economical and efficient. As discussed later, PFRA has identified opportunities to alter the management structure and operating practices to reduce costs and improve operational efficiency and cost recovery.

8.167 At present, PFRA's 87 pastures are grouped within 6 supervisory districts, each with an area manager and an assistant manager responsible for administering 10 to 15 pastures. There is also a pasture manager for all but a few pastures, which share a manager.

Assisted by seasonal and casual pasture riders, the manager handles grazing, movement of livestock, grass resources, and facilities such as housing, bull sheds and corrals. The workload is heavy from May to November but light during winter months, when care of bulls is the main activity.

8.168 PFRA has identified alternatives that could reduce annual expenditures by $1 million to the entire 1986-87 budget of $13.5 million. Some of the possibilities are using seasonal pasture managers, doubling up on management responsibilities, or eliminating or turning over aspects of the operations to provinces or private interests. We have been advised that most of these alternatives have not been implemented because of resistance by farmers. The ultimate choice or combination of choices will involve not only fundamental decisions about the objectives of the community pasture program but also issues such as the degree to which the program should be financially self-sufficient.

8.169 **The Prairie Farm Rehabilitation Administration should reassess the full range of pasture management options and select the most appropriate. With this information, it should reconsider, in consultation with the Treasury Board, the degree to which the program should be financially self-sufficient.**

> *Department's response: The Prairie Farm Rehabilitation Administration carried out a major study and received approval for the present program objectives and cost recovery principles and formula in April 1979. A report on costs and recoveries, as well as proposed grazing and breeding fees, is produced annually. The Prairie Farm Rehabilitation Administration agrees, in addition, to review in consultation with Treasury Board and assess pasture management options including divestiture to the provinces where increased efficiency may be possible (consistent with patron requirements for levels of service) to ensure the most appropriate option is selected. To be completed by March 31, 1987.*

Emergency Drought Assistance: Livestock and Crops

8.170 The emergency drought assistance program is designed to provide assistance to livestock and crop producers whose operations have been adversely affected by drought.

8.171 **Livestock drought assistance.** Severe droughts in 1980, 1984 and 1985 devastated many crops in the prairie provinces. In 1980, the federal government introduced a $45 million herd maintenance program to assist farmers and ranchers in meeting winter feeding costs. Farmers with beef cows, milk cows, breeding mares or sheep in severe drought areas were eligible for assistance provided theiraverage crop yields were below 84 per cent of normal township yields. Funds were allocated per head of livestock.

8.172 In 1984 and 1985 joint federal and provincial livestock drought assistance was provided with contributions as set out in the following table:

Livestock Assistance Funding

Government	1980	1984 ($ millions)	1985
Federal	$ 44.9	$ 30.1	$ 48.0
Manitoba	-	2.0	1.0
Saskatchewan	-	16.5	15.8
Alberta	-	15.0	29.0
	$ 44.9	$ 63.6	$ 93.8

Assistance was primarily intended for the purchase and transportation of feed, but could be used for other operating expenses. In 1984, the Manitoba and Saskatchewan applicants had to agree to retain a minimum of 75 per cent of their herds. However, in 1985 this requirement was withdrawn.

8.173 Statistics Canada data show a mixed performance in the livestock breeding sector in the prairie provinces since 1980-81. Beef breeding numbers have declined by 43,000 (from 347,000 in January 1979 to 304,000 in January 1986) despite emergency funding assistance in 1984-85 and 1985-86. However, dairy breeding numbers have been stable and sheep numbers increased until 1982, although they have since declined to 1979 levels. Although the program appears to have contributed, to some extent, to stabilizing the livestock populations in the prairies, there has been no evaluation since 1982 to determine whether it has been cost effective or helped to resolve fundamental concerns such as inadequate water and feed supplies.

8.174 We believe that emergency assistance, which has been used in three of the past six years, has not been more successful because it does not focus on long-term solutions. The Department does not have a complete strategy for addressing the long-term needs of the livestock sector. For example, although preliminary work has been done in some areas, it has not assessed various alternatives for reducing vulnerability such as new seeding and fertilization of pastures, feed banks for forage crops and grains, or mechanisms for preserving and upgrading forage.

8.175 Since the mid-1970s, the Department and the prairie provinces have tried to establish forage insurance programs. Until 1985 these met with little support from the farming community because the forage growth assumptions werebelieved to be inaccurate, and the programs did not meet farmers' needs. The absence of viable insurance programs contributed to the decision to proceed with emergency assistance in 1980, 1984 and 1985. In 1985, Alberta and Manitoba changed their approach, proposing a feed security coverage, which received an immediate positive response from farmers. This may reduce the need for future emergency assistance. With better linkage between PFRA, the Research Branch and the Crop Insurance Division, and agreement by the provinces, such a solution could have been found earlier and the need for emergency assistance possibly reduced or avoided.

8.176 The Department of Agriculture should address, in co-operation with the prairie provinces, long-term solutions to livestock problems arising from drought conditions in the prairies.

> *Department's response: The emerging federal-provincial forage insurance and red meat stabilization plans represent as part of the on-going process, responses to the need for long-term solutions. While proposals for longer term solutions will continue to be developed and put forward for consideration, it is felt that there will continue to be a need to respond to natural disasters (e.g. multi-year droughts) which, at times, cannot be effectively dealt with only through on-going programs. In this regard, a federal-provincial working group has been tasked with bringing forward recommendations to Ministers dealing with disaster assistance.*

8.177 **Crop drought assistance.** This emergency program, administered by PFRA for the Department of Agriculture, was approved in January 1986 and provides financial assistance of $150 million to dryland producers of cereal grains (wheat, oats, barley and rye) and oilseeds (flax, canola, mustard and sunflowers). The federal government expected the provinces to match this funding, but they did not. Funding is spread over two fiscal years: $95 million for 1985-86 and $55 million for 1986-87.

8.178 Most prairie grain and oilseed farmers also participate in both the Crop Insurance and the Western Grain Stabilization Act programs. These two programs are intended to be complementary policy instruments, whose ultimate objective is to improve the cash-flow of producers experiencing income losses, but the Department does not know the effects of using these programs together. Due to market conditions it now appears that farmers are eligible to receive all three forms of assistance. Crop drought assistance can be up to $15 an acre. The impact, interaction and effectiveness of these programs have not been thoroughly investigated and are not well understood.

8.179 These uncertainties were not set out in the Department's December 1985 request seeking Treasury Board and Cabinet approval for the $150 million Emergency Crop Drought Assistance. Nor did the submission to Treasury Board identify the costs and benefits of alternative courses of action – such as low interest loans to producers. In addition, no effectiveness measures were defined.

Toxic Waste and Hazardous Materials

8.180 In our 1982 Report, we noted deficiencies in the health and safety practices of the Research Branch of Agriculture Canada and recommended that:

- procedures should be developed for handling, transporting, storing and disposing of toxic and dangerous substances; and

- up-to-date inventories of all hazardous material should be maintained.

8.181 During this audit, we reviewed the Department's progress on these recommendations, visiting laboratory facilities and research stations on a test basis both within and outside the National Capital Region. We are concerned that sufficient attention has not been given to implementing our 1982 recommendations.

8.182 **Functional responsibility.** Functional responsibility for developing and promulgating procedures for handling, storage and disposal of dangerous substances has not been effectively assigned by Agriculture Canada. Responsibility is shared between research scientists and Facilities Planning at headquarters, and the director of each facility, who passes it on to research scientists who volunteer for the local Joint Occupational Safety and Health (JOSH) Committee.

8.183 Treasury Board's Personnel Management Manual describes how JOSH committees are to be constituted and specifies that they must meet on a regular basis. Minutes and recommendations are to be submitted to responsible local managers who will inform the committee of proposed action on each recommendation.

8.184 Although JOSH Committees have been set up at each of Agriculture Canada's facilities as required by the Treasury Board procedure, the level of activity of the committees varies, as discussed below.

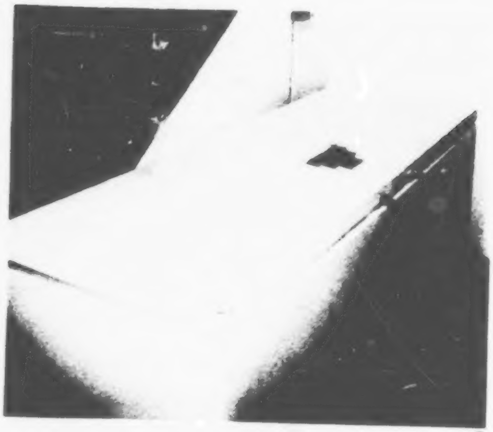
8.185 **Procedures.** Different standards are being adapted and used by individual facilities. Where the chairperson of the JOSH Committee places a high priority on it, the committee may be active and may develop standards and procedures and ensure they are followed. In other cases, this may not happen. In some facilities, committees have not met for years. In its review of research facilities, the Department's Internal Audit noted that in three of seven facilities visited, JOSH Committees were not meeting regularly. In two others, although the Committees met regularly, procedures for handling toxic waste were notpromulgated. Clearly, the Treasury Board procedure is not being adhered to in some cases.

8.186 **Storage facilities.** In the National Capital Region, in areas set aside for the storage of chemicals prior to disposal, we saw accumulations of chemicals labelled "unknown", and even "explosive". It was explained that they come from various laboratories, and when they are not identified, they are labelled hazardous or explosive, as a precaution, even though they may only be distilled water. However, chemicals with such labels may in fact be hazardous or explosive.

8.187 At the Research Branch, we were told that, since 1981, the co-ordinator of toxic waste disposal would not accept unidentified chemicals for storage prior to disposal. We could not find out where the Branch's unidentified chemicals are accumulating, where they are being disposed of and by what means disposal is effected.

8.188 We visited three storage facilities in the National Capital Region, under the responsibility of either the Research Branch or the Food Production and Inspection Branch,

1



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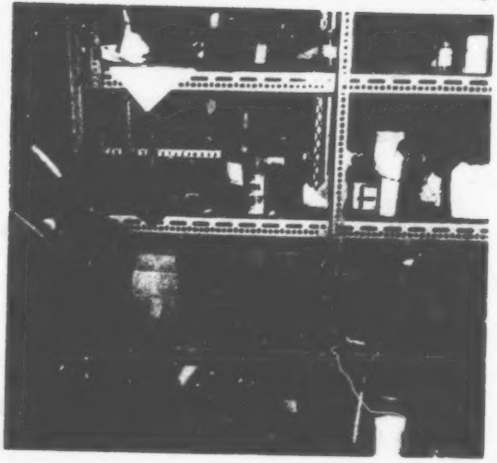

5

1. Drum of chlorinated waste solvents on an open loading dock near a major public roadway. 2. Unlocked freezer of pesticide residue near an unguarded main doorway. 3. Potassium cyanide awaiting disposal. 4. Unidentified chemicals in temporary storage. 5. Unidentified chemicals in storage since 1981 (see paragraphs 8.186 to 8.189).

set aside for hazardous and waste chemicals that are to be disposed of. Two of these were described as temporary, pending the availability of capital for construction of adequate facilities. They were both uninsulated, crowded and contained accumulations of unidentified chemicals. At one facility, the storekeeper said one of the stored packages contained PCBs but could not identify which. At the same facility, we saw containers labelled "rabies virus in acetone – highly hazardous". This material was accumulating until adequate disposal procedures were developed.

8.189 During our visits to other facilities in the National Capital Region, we also noted the following questionable practices:

- At a waste storage facility, a full drum of chlorinated waste solvents, labelled as highly hazardous, was left for several weeks on an open loading dock within 30 metres of a major street.
- Large quantities of highly volatile ether, which boils at 36°C, were stored in an uninsulated building. We were advised that on some hot summer days, the metal containers bulged from internal pressure.
- Two large freezers labelled "pesticide residue" were left unlocked within a few metres of an unguarded main door of a facility.

8.190 Although several initiatives are now under way to remedy existing deficiencies surrounding the handling, storage and disposal of dangerous substances, we believe that, as a matter of urgency, the Department of Agriculture should:

- **promulgate policies and procedures for storage, handling and disposal of dangerous substances in all facilities;**
- **identify accumulated substances so that they can be disposed of in an appropriate manner and, in future, require that laboratories label all chemical wastes before sending them for disposal;**
- **provide appropriate facilities for storing dangerous and toxic materials; and**
- **ensure that Joint Occupational Safety and Health committees meet on a regular basis and monitor adherence to established departmental policies and procedures.**

Department's response: The Department recognizes that the storage and handling of toxic waste and hazardous material must be of the highest priority. While the Department has made a significant investment in developing a standardized safety program for all of its laboratories, a Task Force, headed by a senior research scientist, was appointed on April 15, 1986 to address this issue and to ensure completion of the following by June 30, 1987:

- *completing the development of policies and procedures for storage, handling and disposal of dangerous substances in all facilities across the country;*

- *completing the development of an up-to-date inventory of all accumulated substances, which will continue to be maintained by the Department;*

- *completing the development of standards for the provision of appropriate facilities for storing dangerous and toxic materials; and*

- *reviewing and revising, where necessary, the structure and operations of the JOSH committees, including their Terms of Reference to ensure adherence to Departmental policies and procedures.*

DEPARTMENT OF EXTERNAL AFFAIRS
TRADE FUNCTION

DEPARTMENT OF EXTERNAL AFFAIRS
TRADE FUNCTION

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9

DEPARTMENT OF EXTERNAL AFFAIRS TRADE FUNCTION

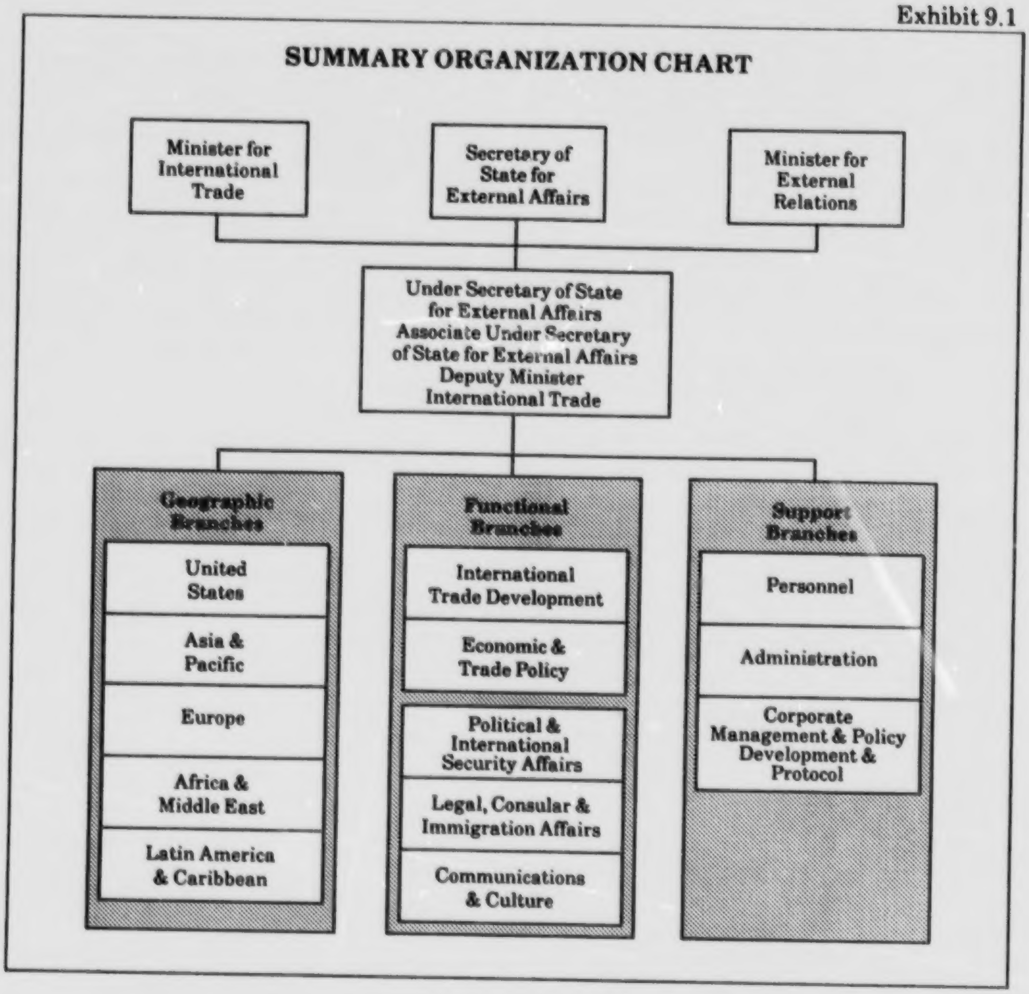
Introduction

9.1 In January 1982, the Government of Canada announced a major restructuring of the Department of External Affairs designed to provide a more co-ordinated approach to pursuing international export markets and to give greater priority to economic matters in developing foreign policy. As a result, several activities previously assigned to the former Department of Industry, Trade and Commerce were transferred to the Department of External Affairs. The objective of this transfer of resources and responsibilities was to ensure a greater measure of coherence in managing Canada's international relations by making economic and trade considerations a more integral part of overall foreign policy. The result of the restructuring was to establish a Department of External Affairs with responsibilities substantially increased beyond its traditional role of formulating foreign policy and maintaining diplomatic contact with other nations. This integration of trade and diplomacy is still going on.

9.2 **Organizational structure and activities.** The Department of External Affairs is organized into five functional branches, five geographic branches, and three support branches (see Exhibit 9.1). The International Trade Development Branch and the Economic and Trade Policy Branch are the primary functional responsibility centres for implementing the Trade function and formulating trade policy. The other three functional branches – Political and International Security; Legal, Consular, and Immigration Affairs; and Communications and Culture – perform functions relevant to the domestic and international roles of the Department. The five geographic branches are primarily responsible for bilateral trade policy and delivering the Trade function outside Canada through the various Canadian Embassies, High Commissions and Consulates General. The Corporate Management, Policy Development and Protocol Bureaux, the Personnel Branch, and the Administration Branch provide support services throughout the Department.

9.3 **Resources.** It is difficult to separate the cost of the Trade function from other functions in the geographic and administrative support branches. At Headquarters in 1986, a total of 234 program and 127 support staff were allocated to the Trade function elements of the International Trade Development and Economic and Trade Policy Branches. In the geographic branches at headquarters, approximately 113 program and 37 support staff have been allocated to the Trade function. Another 1,025 person-years were devoted to Operational Support, Human Resource Planning and Administration for the whole Department. The Department spent about $96 million on direct trade activity and $100 million on administrative support during the fiscal year 1985-86. At Posts, 756 person-years were allocated to Trade.

Exhibit 9.1



SUMMARY ORGANIZATION CHART

Minister for International Trade
Secretary of State for External Affairs
Minister for External Relations
Under Secretary of State for External Affairs
Associate Under Secretary of State for External Affairs
Deputy Minister International Trade
Geographic Branches
United States
Asia & Pacific
Europe
Africa & Middle East
Latin America & Caribbean
Functional Branches
International Trade Development
Economic & Trade Policy
Political & International Security Affairs
Legal, Consular & Immigration Affairs
Communications & Culture
Support Branches
Personnel
Administration
Corporate Management & Policy Development & Protocol

9.4 **Trade patterns.** The Department of External Affairs consists of a Headquarters in Ottawa and 121 Posts located around the world. Most Posts (34) are located in Europe, followed by Africa and the Middle East (29), Asia/Pacific (20), Caribbean and South America (18), and the United States (14). Six Multilateral Posts serve the United Nations, NATO, and the Organization for Economic Co-operation and Development (OECD). By far the largest portion of Canada's trade takes place with the United States. According to 1985 figures, the United States accounts for approximately $90 billion of Canadian exports. For the same period, Canadian exports to Europe were about $9.9 billion and about $10.8 billion to Asia/Pacific. These numbers do not reflect the full dollar value of all Canadian trade relationships; for example, trade in services is not included. Nevertheless, the United States, Europe and Asia/Pacific together account for more than 90 per cent of Canada's trade with the world.

9.5 Although Canada's total trade volume has continued to grow, this growth has been almost entirely related to an increasing concentration of trade with the United States.

For example, in a list of some 22 OECD countries with which Canada traded in 1981-83, Canadian exports declined in 19 countries, and increased significantly only with the United States by 16 per cent and Japan by 5 per cent. While trade patterns are to a certain extent cyclical, in this period Canadian exports to the European market declined by 22 per cent, Latin America by 27 per cent, and Africa and the Middle East by 16 per cent. Since 1983, Canada's trade with Europe has remained stable, increased slightly with Asia, and increased by about $25 billion with the United States (See Exhibit 9.2).

9.6 In the last decade, Canada's share of total world trade has declined. This aspect of Canadian trade is reflected in a 1985 Canadian Manufacturers' Association Report on Canadian Competitiveness. In this report, Canada ranked 15 in a list of 28 countries in terms of "outward orientation", a general approach within the business community reflecting interest in the sale of products abroad. Given that Canadian exports account for 31 per cent of Gross Domestic Product, the importance of Canadian trade to the nation's economy is obvious. This in turn highlights the importance of the work the Department of External Affairs performs in support of Canadian trade abroad.

Audit Scope

9.7 We divided the audit of the Trade function in the Department of External affairs into two categories of activity: Trade Development and Program Administration.

9.8 In Trade Development, we reviewed:

- the operation of the Program for Export Market Development;
- the level of service provided by Trade Officers at Headquarters and Posts for trade fairs and missions, general business inquiries, and the collection, analysis, and dissemination of information; and
- operating relationships between the various government departments involved in trade promotion and market access.

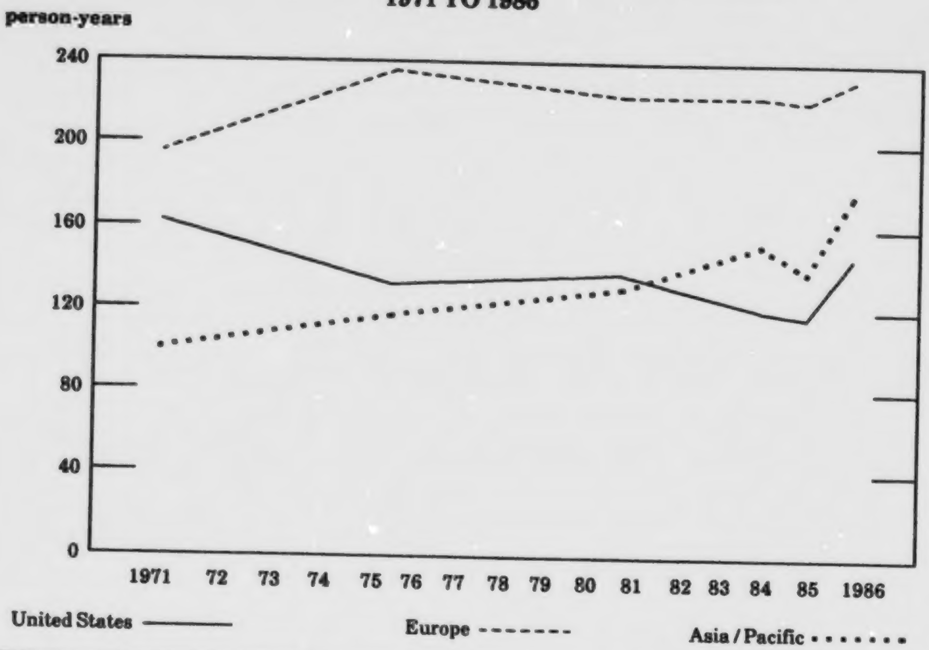
9.9 For the on-site review of the foreign operations component of the Trade function, we selected six Posts in the United States, two in Europe, and two in Asia.

9.10 In Program Administration, we audited the External Affairs' Post Planning System in relation to the activities of Trade Officers at Posts, the program evaluation function, electronic data processing equipment, and the departmental personnel system that supports the Trade function.

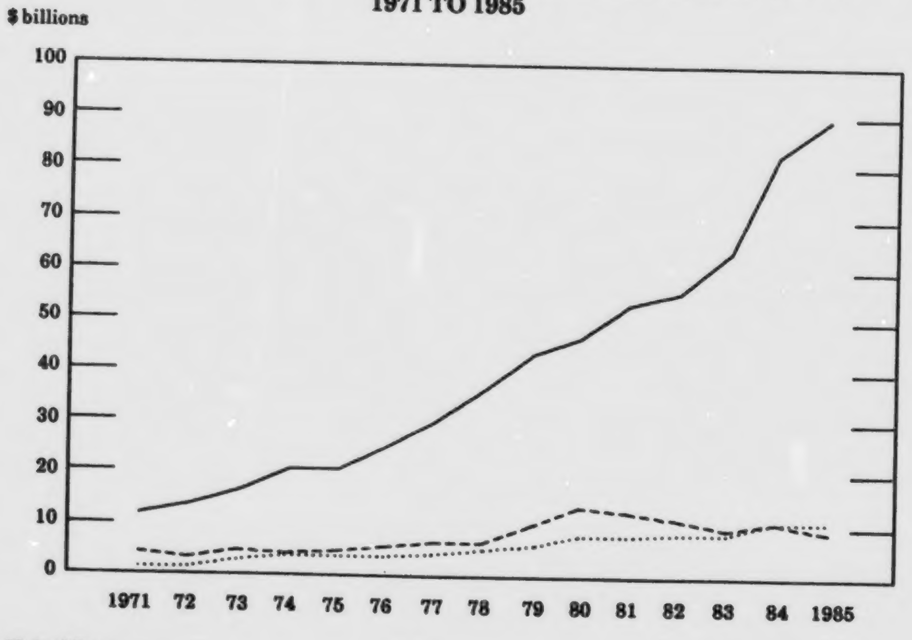
9.11 Our audit is limited to the Department's actions up to 31 March 1986. Procedures implemented by the Department since that date have not been audited, although some were brought to our attention and are included in the departmental responses.

Exhibit 9.2

TRENDS IN CANADA'S USE OF TRADE OFFICERS 1971 TO 1986



CANADA'S EXPORT TRADE IN ITS THREE MAJOR MARKETS 1971 TO 1985



Trade Development

9.12 **The Trade function - how it works.** The Embassies and Consulates General abroad are the leading edge of the Department of External Affairs' efforts in support of Trade. On average, Posts have 3 to 4 Trade Officers with the larger Posts ranging up to 20 Trade Officers. The Posts provide assistance to Canadian business attempting to penetrate foreign markets. The Posts also assist foreign business wishing to invest in Canada or to purchase Canadian goods and services. Posts assist in organizing trade and economic missions to and from Canada, participate in international trade fairs, identify foreign investors, conduct sectoral market analyses and provide advice on international trade policy.

9.13 External Affairs Headquarters plays a central role in the Trade function. Other government departments, such as Agriculture Canada and the Department of Regional Industrial Expansion (DRIE) also have responsibility, as set out in their Estimates, for identifying and developing international marketing opportunities. In support of its mandate to "co-ordinate Canada's international economic relations" and "foster the expansion of Canada's international trade and commerce", External Affairs uses the sectoral and technical expertise of other departments to develop trade policy, identify Canadian sources of supply and develop marketing strategies and plans.

9.14 The Department of External Affairs has three basic ways of using its resources to ensure that foreign markets are developed to the maximum benefit of the Canadian economy. One method is to use Trade Officers in the United States and abroad to provide a certain level of service to business representatives in their attempt to penetrate foreign markets. The second method is to provide direct program funds to business through the Program for Export Market Development (PEMD) and the Promotional Projects Program. The third method is through the acquisition and dissemination of information.

Level of Service

9.15 Level of service refers to the range of activities engaged in by a Trade Officer to respond to the requests made by the business community. Guidelines reflecting the type and extent of services provided by the Posts to assist business have not been established by the Department. Because of the nature of the job, Trade Officers are required to respond to a wide range of business requests. Work tasks can vary a great deal depending on the Post and the nature of the request. Work tasks may be initiated by a letter, an unexpected personal appearance of a business person at Post, or a need to provide a general briefing to a visiting trade mission. Usually, however, the Trade Officer is attempting to identify the most appropriate contacts in the country, those that will offer the best opportunity for Canadian business to gain entry into local markets. Trade Officers arrange appointments and often accompany business people to meetings and in tours of operations, particularly when the country is significantly different in culture from Canada.

9.16 Trade Officers also arrange itineraries for visiting missions from Canada, set up receptions, and handle tour logistics. A visiting mission normally includes representatives of several Canadian companies and governments that meet with industry representatives in the host country. This activity usually includes both formal and informal briefings. The type of work carried out by the Trade Officers is labour intensive and repetitive. Trade Officers are also responsible for responding to a wide range of correspondence from businesses seeking information about foreign markets.

9.17 The specific tasks of a Trade Officer are difficult to anticipate on a day-to-day basis. These tasks vary in range and intensity from Post to Post. The amount of time devoted to specific tasks is more a function of the time that a specific officer has available than a departmental definition of the type and range of service to be supplied in response to a specific request for assistance. Under these circumstances, individual Trade Officers make daily decisions based on their own judgements and interpretations of desirable levels of service to be provided. This leads to wide variation in the emphasis given to particular kinds of work performed in support of the Trade function.

9.18 The Department has no documented standard against which to assess Officers' activities in relation to meeting business demands for service. Statistics are not consistently maintained to determine the level of business demand or to record the specific tasks performed by the Trade Officers at Posts. Such statistics and a clear definition of the expected level of service to be provided under various circumstances would improve the basis for allocating staff and controlling costs. The Department has recognized the need for workload information and is implementing a system to monitor Trade Officer activity. The Head of Post is in the best position to determine the level of service needed to meet local conditions. The level of service established at Posts needs to be endorsed by Headquarters to ensure an appropriate match with departmental goals.

9.19 Through information provided by individual Posts, the Department of External Affairs should establish and agree upon the level of service to be provided by the Posts to meet local conditions in response to requests for assistance received from the business community.

> *Department's response: There are problems in applying comparable level of service standards across all posts, given the enormous variation in local conditions and services required by Canadian businesses. However, the Department does agree that it would be useful to make information more readily available to business on the variety and types of service available at posts abroad.*

Program for Export Market Development (PEMD)

9.20 **Program design.** PEMD is the major export market development program for international trade promotion. This $35 million (1984-85) program is jointly delivered by DRIE and External Affairs using approximately 26 External Affairs person-years and 70 DRIE person-years. Some 6,000 applications for contributions are received annually, and there are approximately 15,000 open project files. The objective of PEMD is to develop, increase, sustain and diversify the export of Canadian goods and services by sharing with the business community the financial risk of entering foreign markets. PEMD does this by making contributions to the cost of developing export markets incurred by Canadian companies that meet certain eligibility criteria. For example, PEMD is to provide an incentive only when there is a need to share the financial risk of penetrating foreign markets. The program is intended to be responsive to export marketing initiatives of Canadian companies.

9.21 The PEMD office in the Department's International Trade Development Branch is responsible for program administration. External Affairs' functional and geographic branches, Posts abroad, DRIE sector branches and regional offices are all involved in program delivery. For example, DRIE regional offices may receive applications; advice on the appropriateness of contributions may be obtained from sector branches and Posts; the Assistant Deputy Minister, International Trade, may approve the project; and External Affairs' Headquarters is responsible for the initiation of recovery procedures. With such a large number of players, it is important for all participants in program delivery to have a clear understanding of responsibility and accountability relationships.

9.22 Decisions on how many people are needed to deliver the program in both departments are not made in conjunction with decisions on the amount, type and distribution of contribution funds. No unit in DRIE has overall responsibility for DRIE delivery of the program. Program managers have not translated program objectives into measurable operational objectives, service levels or performance indicators. There is no linking of funding to important market development sectors, the Promotional Projects Program plan, or Post Plans. Yearly allocations of funds to delivery units are based on past expenditure trends, with the exception of sector priorities for food, fish and urban transit.

9.23 **Funding process.** The 1984 Policy and Administrative Directive approved by Treasury Board, provides clear guidelines on the criteria for assessing applications. These include guidelines with respect to "incrementality" stipulating that, to be eligible for assistance, a company must either be not willing to assume, or financially not capable, to assume the risk of a market initiative. These guidelines are difficult to enforce since a company frequently must take the initiative without PEMD approval because the time frame to participate in such a business initiative is often limited. The dilemma is that taking the initiative indicates a willingness to assume the risk of the venture and hence makes the company ineligible for assistance. Companies take the initiative assuming they are eligible for a PEMD contribution and that funding will be approved retroactively. Different delivery units interpret the "incrementality" criteria differently.

9.24 We found that PEMD officers did not always adequately review and assess companies' track records in implementing previous PEMD-funded projects. Some financial analyses were either not done or not done well. Company marketing plans were not always thoroughly reviewed. In some cases the companies receiving funds did not meet the eligibility criteria, had not performed well on several preceding projects, or had not submitted the required reports. Information on the companies' capabilities and/or market conditions was not always complete, accurate or appropriately analysed by the reviewing officer. In December 1985, when the program faced a 30 per cent cutback, new terms and conditions for approval of projects prohibited approving new projects if the company did not submit Business Data Reports for prior projects. Also, if the company did not have a successful project (that is, incremental sales) in the seven immediately preceding projects, the application was to be turned down.

Case Study - Assessment of Company Track Record

9.25 PEMD directives require that a company's track record with PEMD be assessed prior to approving new projects. This assessment should consider whether the commercial risk for the project is higher than that normally assumed by the company, whether the project is a departure from the company's normal international marketing activities, and whether the project has a reasonable chance of success based on the company's past performance. One company that experienced growth and profitability as a result of expanding exports since the early 1970s received numerous project approvals. In particular, when a project was approved in September 1984 for $222,116, the firm and its subsidiaries and divisions reported its last major PEMD-assisted success in 1981. Since the date of its last success, PEMD approved 42 additional projects for the group.

9.26 In another case, a company received four project approvals in four months in 1985 for a total of $70,623 – even though it had not reported success for any of its 10 previous projects. Business Data Reports were submitted for only four of those projects.

9.27 In January 1986, a company received approval for a project for $31,000 even though the applicant had submitted Business Data Reports on sales achieved for only 2 of its 12 previous projects.

9.28 Full implementation of the new terms and conditions should prevent the recurrence of similar cases.

9.29 **Commitment and cheque issue.** Departmental controls over commitments and cheque issue of PEMD funds are generally satisfactory. DRIE reviews claims for payment to ensure the cheque amounts are in accordance with contractual arrangements. We found few instances where unsupported claims were paid.

9.30 **Monitoring.** Companies are required to submit activity reports to substantiate claims for payment. The information in these reports is not adequate to support PEMD decision making. They do not contain all the information necessary for officers in delivery units to monitor projects, substantiate claims for payment, assess project success and evaluate future project applications. For example, activity reports do not indicate which trade fairs were attended or what contacts were made. Further, activity reports are not filed in a standard, easily accessible way and they are not always distributed to Posts. Officers at Posts do not receive appropriate information on the results of PEMD assisted activity.

9.31 There is inadequate monitoring of larger projects. For contributions relating to the establishment of sales offices abroad, there is a requirement that the assessing unit do a formal annual review prior to releasing PEMD funds. We found many cases where no review occurred until after the expiry date and that Posts were unaware of sales offices established in their areas. These projects usually involved amounts greater than $250,000.

Case Study - Monitoring the Establishment of Sales Offices

9.32 In November 1983, a transportation equipment manufacturer received approvals for financial assistance to establish sales offices in three cities in the United States. The amount authorized to assist the company was $752,477, to begin February 1983 and expire February 1986. As of March 1986, $523,950 had been spent. However, no formal annual reviews had been undertaken. The Trade representatives at Post had no knowledge of the existence of the sales office that had been established in that city. The new terms and conditions emphasize the need for annual reviews.

9.33 PEMD managers have concentrated on monitoring the quantifiable aspects of the program, such as the number of applications received, the timeliness of processing, the number of approvals given, and the dollars expended and recovered. Analytical review has focused on approval trends and levels of expenditure by section and delivery unit. Progress has been made in establishing an adequate data base. However, adequate qualitative information on program results has not been collected.

Case Study - "Incrementality"

9.34 In May 1983, the Department received an application for assistance to open six sales offices in the United States. The applicant had always geared production to export over 80 per cent of its product to the United States. It was preparing to launch a new product and believed that it needed a sustained market presence. The application was made on the basis that the company did not have enough capital to fund the venture itself. The application was approved in February 1985 for $350,000 toward the eligible costs of operating the six sales offices in the 1984 calendar year. Clearly this is a retroactive approval of a project that the company was willing to undertake without the certainty of receiving government assistance.

9.35 Eligible costs included rental of sales offices, salaries for sales managers, costs of support staff and other operating costs. The first claim was received in late April 1985. As of March 1986, $191,401 had been paid to the company. A review of the supporting documentation accompanying the claims for payment revealed that six salespeople were working for the parent company in five U.S. locations as early as March 1983. The parent company had entered into lease agreements for cars in July 1982 and March 1983 for the six people. This contradicts the criteria for approval on the basis that there was a need to share the financial risk of penetrating a foreign market. It was difficult to determine whether actual sales offices were established; office expense claims did not include accommodation rental costs. Business addresses for the company could not always be found in the trade directories for the areas served by the new offices. Costs of operations claimed by the company consisted of answering services, postage, photocopies, etc. Although payments are generally well scrutinized, in this case payments were made without supporting documentation for the major portion of expenses – salaries of $206,407 for six sales managers, of which PEMD reimbursed $103,204. Although support staff costs had been included in the budget, no other office staff was hired or included in the 1984 and 1985 expenses.

9.36 No annual reviews have been undertaken to date. Posts did not know about the company's project activities in their areas. In response to our enquiries, DRIE requested supporting documentation from the company and verified the amount claimed and paid.

9.37 **Repayments.** A condition of receiving a PEMD contribution is that the company must repay the contribution if it achieves increased sales in that market. Repayments are usually 2 per cent of the new sales, and the government expects full recovery on successful projects. The procedures to identify and collect recoverables do not ensure that maximum recoveries are made. Controls over these repayments do not comply with the Treasury Board Guide on Financial Administration.

9.38 Treasury Board Directives require that claims be entered promptly into departmental records; prompt and vigorous action be taken to collect all claims; and claims not be removed from departmental records until satisfied by payment or by properly authorized deletion action. Treasury Board guidelines suggest that departments determine the limits of the collection actions that are warranted and feasible, examine on a regular basis all overdue accounts and, when such action has been exhausted, initiate action to delete uncollectable accounts promptly. Departments are to take continuous action to collect overdue accounts and prepare reports documenting the action taken, the success achieved, and the problems encountered.

9.39 The Business Data Reports (BDR) are the basis for determining the amount of recovery and must be filed by PEMD recipients. BDRs are often incomplete and contain poor quality data. These reports are not consistently submitted by companies. Delivery units have claimed a lack of resources as the reason for not following up on delinquent reports. Departmental audits of companies have indicated a high rate of non-reporting of sales, meaning that money owed to the Crown may not have been collected. As a result of audits, recovery action has been undertaken and significant amounts have been collected. In November 1984, the PEMD office decided to redesign the BDR form to clarify the repayment obligation. However, this initiative has been delayed by the redesign of the program.

9.40 The amount of auditing of the contributions for potential repayment is not sufficient. Since 1982-83, only one person-year has been devoted to these audits. This permits an audit coverage of only 2 per cent of projects that have reached their expiry date. The projects to audit are selected judgementally – hence, they may not present a representative picture of the sales actually achieved by participating companies. The PEMD office has recently sought the assistance of Supply and Services Canada, Audit Services Bureau, to devise an appropriate sampling plan.

9.41 During 1985, when a new computerized information system was being implemented and additional strains were placed on staff, management placed a low priority on the collection of recoverable amounts. From April to October 1985, the PEMD office sent no notices to the Finance Branch directing it to invoice companies. Further delays occurred with respect to the recoverables identified as the result of the PEMD auditor's work. Also, the PEMD office was slow to respond when Finance Branch sought advice from the PEMD office prior to turning long overdue accounts over to the Department of Justice. Management action has now been taken to ensure prompt collections.

9.42 No aged accounts receivable reports were prepared for review by senior program managers. No deletions of uncollectable amounts have been made since 1978. In February 1986, 25 accounts, totalling $295,440 and dating from 1983 and earlier, were still uncollected. No accounts have been sent to Justice for collection. The Department has since taken recovery action for the two major accounts, amounting to 70 per cent of the above balance.

9.43 As of March 1985, $6.3 million had been recovered from PEMD recipients. PEMD management has conservatively estimated the recoverable amount to be approximately $11 million. In 1978, 1979 and 1980, the Treasury Board directed PEMD management to institute procedures to increase recoveries. The repayment terms were subsequently increased from 1 per cent to 2 per cent of reported sales. However, the procedures to identify and collect amounts have not changed significantly.

9.44 **Program redesign.** PEMD has undergone extensive internal reviews since 1979. However, these reviews have not measured program effectiveness, and major recommendations have not been acted on. External Affairs is redesigning the Trade Promotion Programs and has told us that it will consider our observations in the redesign.

Promotional Projects Program

9.45 The Promotional Projects Program provides funds for organizing national exhibits at trade fairs outside Canada and for organizing trade missions abroad and in Canada. In 1984-85, $15.2 million was budgeted for this program. Of this, $8.6 million was paid to the Department of Supply and Services' Canadian Government Expositions Centre to design and construct exhibits and rent floor space at trade fairs.

9.46 Promotional Projects Program activities at Posts absorb a significant proportion of Trade resources abroad. There is a reasonable process for planning and implementing the program, but the long-term effectiveness of Canadian government information booths at trade fairs has not been assessed by the Department. Further, External Affairs does not apply a consistent rationale in selecting firms to attend fairs. Although some goals are set for each trade show, significant information on the benefits to the participating Canadian business is not available in the Department. The Department has stated that these concerns will be addressed in a redesigned Trade Promotion Program.

Information Acquisition and Dissemination

9.47 Management of information is a fundamental component of effective international trade development. The Department of External Affairs procedures for collecting, analysing and disseminating trade information require improvement.

9.48 A significant portion of a Trade Officer's time at Post is devoted to collecting, organizing and disseminating trade-related information. An External Affairs file system exists for the Posts within which all trade information is supposed to be organized, but not all Trade Officers' working files are referenced to the departmental system.

9.49 External Affairs Trade Officers at Post are replaced regularly by new incoming officers. In this type of rotation, the Trade Officer's records are essential to maintaining continuity of service with the business community. The possible loss of key information accumulated by the officer over the term of the posting could reduce this continuity. The Department does not have a documented hand-over procedure for records to be followed when officers are reassigned.

9.50 **Statistics.** Trade Officers at Headquarters and Posts receive a variety of data from Statistics Canada. This information is provided in the form of publications available to the general public and in custom-made reports requested by the geographic and functional branches. Officers at Posts also obtain statistical information from local sources. There is little uniformity or consistency of analysis in the use of statistical information. The Department of External Affairs does not provide regular reports giving an up-to-date picture of international trade activity, Canada's current position, and the contribution of the Department in support of specific sectoral initiatives. Such information is fundamental to managing the Trade function on an international level. However, in response to specific requests, the Department can, and does, produce such reports either on a bilateral or multilateral basis.

9.51 Trade Officers receive no training in the use of statistical information to assist them in identifying market trends or specific market opportunities. Neither regular nor standardized statistical reports are prepared by the Department for use at Headquarters or in other government departments. The Posts do not regularly prepare statistical reports with consistent information categories. Those that are prepared are not systematically reviewed or analysed by a central statistical group, or sent to other Trade Officers working in the same trade sectors. There is no centralized statistical group at Headquarters responsible for managing statistical information. As a result, information is not used to best advantage in forecasting trends and developing action plans for the Trade function.

9.52 **The Department of External Affairs should assign to a specific responsibility centre the responsibility for establishing and implementing policies for collecting, analysing and disseminating trade information.**

> Department's response: *An evaluation of trade information services is in progress; this recommendation will be considered after the evaluation has been completed.*

9.53 **Sector specific strategies.** One very important aspect of the information role played by the Department of External Affairs in support of trade development is that of providing funds and people to assist in developing marketing strategies for specific products in clearly identified foreign markets. We reviewed the Department's efforts in support of marketing Canadian pork products in Japan, to assist us in developing a broader understanding of the relationships among the various players in a foreign market situation.

9.54 We also discussed with officers at Posts the sectors that were the most important to Canadian exports to their region and their efforts at developing market strategies. In almost every instance, officers were attempting to develop strategies for their sectors; however, the Department has not always provided the guidance necessary to ensure the quality of these studies. Officers indicated a need for guidance in terms of content and input from Headquarters, other government departments and sectoral experts. In addition, the officers at Posts are engaged in many other activities that have higher priority than the development of sectoral strategies. Thus, many of these initiatives do not develop into action plans providing assistance for Canadian business.

Case Study - Pork Marketing in Japan

9.55 The Japanese market for Canadian pork products is second in importance only to that in the United States. While the Japanese market is difficult to penetrate, Canada has achieved some success. At one time Canada had a substantial share of the Japanese market, but recently, the Canadian share of the market was significantly reduced. Canadian pork exports to Japan fell from $202 million in 1982 to $124 million in 1984.

9.56 It is hard to distinguish where government's responsibility for market development and maintenance stops and industry's begins. Those with the most at stake are the companies concerned. However, the government, through External Affairs, undertakes a number of tasks to help business representatives develop markets and to keep the business community informed on market conditions. Whether business acts on the information provided is outside the control of External Affairs.

9.57 In spite of the fact that this trade sector was identified as a priority in the Post Work Plan, our review of External Affairs' activities in support of the marketing of pork to Japan indicated that the Department did not prepare a plan that included the role of DRIE and the Department of Agriculture. Such a plan would set out the appropriate framework of contacts and actions to be undertaken by External Affairs and the other government departments.

9.58 External Affairs did have information on the pork marketing situation, but there was no framework within which to act on it. While the Post and Headquarters took some specific steps toward market development, these steps were not part of an overall management plan. Given the size of this market, we believe an explicit management plan including a framework for action is a minimum expectation in a strategy to protect Canadian trade interests abroad.

9.59 The Department of External Affairs should develop and implement a management framework to ensure that important export sectors are supported in terms of market intelligence, co-ordination with other government departments, and dissemination of market strategies to industry.

Department's response: *Modifications to the trade branch structure are being considered to provide a sharper focus on major export sectors and will therefore improve sector-specific planning and co-ordination.*

Operating Relationships

9.60 In support of its co-ordinating role, External Affairs describes its mandate as one in which the Department uses the sectoral and technical expertise of other departments to develop trade policy, identify Canadian sources of supply and develop marketing strategies and plans.

9.61 Part III of External Affairs' Estimates states that: "The International Trade Development Activity sustains and develops markets for Canadian goods and services.... International Economic, Trade and Aid Policy Activity designs and implements policies aimed at protecting and advancing Canada's economic, trade and aid interests.... It ensures that Canadian policy in these areas is consistent with other aspects of Canadian foreign policy".

9.62 The operation of the Trade function within the former Department of Industry, Trade and Commerce drew on the resources of that Department's Industry Sector Branches, which maintained ongoing contact with industry and other government departments. Currently, most sectoral resources are located in DRIE and in other functional departments of the government. Partly because of the Department of External Affairs' foreign service personnel rotation system, lines of communication between the External Affairs' Trade function and other government departments are difficult to maintain. Further, based on discussions with officials in other government departments, we believe that the division of responsibilities between the functional and geographic branches within External Affairs needs to be more fully communicated to departments outside the foreign service community.

9.63 At the operating level, no consensus has been reached between the Department of External Affairs and other government departments on the best method to work together in pursuit of international trade development. While the Department uses expertise from other departments, we could find no operational guidelines defining the role and responsibility of External Affairs in relation to consultation with the private sector or other government departments.

9.64 **Tourism.** Tourism is a trade sector that historically has been managed by DRIE/Tourism Canada. With reorganization, responsibility for the Tourism function is now shared between External Affairs and DRIE. Tourism Canada sets the overall policy; External Affairs is responsible for program delivery abroad. However, no formal agreement on the Tourism function exists between DRIE and External Affairs. The Department has not defined the relationship between the Tourism program and the Trade function and therefore has not decided the exact Headquarters priority for the delivery of the Tourism program. Meanwhile, however, Personnel Branch of External Affairs has replaced 23 former Canada-based tourism specialists at Posts with locally engaged personnel, and re-deployed the Canada-based person-years to non-tourism operations. The locally engaged staff have not been given any formal training as requested by Tourism Canada. There is no organizational unit in External Affairs Headquarters with overall responsibility for program delivery.

9.65 **Defence products.** In promoting defence products abroad, the current agreement on the allocation of time and activities to be undertaken by Post military attachés in support of the Trade function dates from the period of the former Department of Industry, Trade and Commerce. As a result of the physical separation of the Defence Programs Bureau from the main operating programs to promote the sale of defence products, such as the Defence Industry Productivity Program administered by DRIE, the trade promotion role performed by External Affairs is not well matched at operating levels with the work performed in other government departments. Other organizations working in this specialized sector include the Department of National Defence, the Canadian Commercial Corporation and the Department of Supply and Services. No operational guidelines between the Department of External Affairs and these other departments have been signed or are being negotiated.

9.66 **Communication procedures.** Officers in the Trade function keep or develop lines of communication that reflect their particular work history and personal contacts. Under the formal system of communication, when an issue arises at the Post, the officer advises the "desk contact" in the geographic branch at Headquarters. The desk officer determines the appropriate sectoral unit, functional branch, or other government department to be advised. The requirement to respond to the Post, seek advice from other External Affairs Branches or from other departments, analyse the policy implications of the issue, or develop a plan of action to deal with the issue is at the discretion of the geographic branch. However, with the exception of the United States Branch which has a large number of non-rotational officers, desk officers are part of the rotational foreign service, spending on average two or three years on the desk. Therefore, there is a need to ensure consistent approaches to issues and the involvement of functional experts. No operational guidelines identifying appropriate routes for sectoral communications are in place, and no formal review of communication procedures has been undertaken within the Department.

9.67 **The Department of External Affairs should establish guidelines on operational relationships with other government departments that have an ongoing involvement in developing trade policy and promoting Canadian international trade.**

> Department's response: *The Department of External Affairs has an established system of focal points, as well as several Memoranda of Understanding and interdepartmental consultation committees, for co-ordinating with other government departments on trade policy and promotion issues and for co-ordinating input from these departments into the Department of External Affairs annual planning cycle. The absence of a formal framework and specific guidelines does not impair the Department's ability to resolve these through bilateral consultations. The modifications being contemplated to the trade branch structure (see response to 9.59) are intended to provide a closer dialogue with sectoral departments on trade issues.*

Program Administration

Planning and Control

9.68 The Department of External Affairs has a formal planning system that clearly establishes the flow and timing of information to be sent to Headquarters. The Department has adopted a top-down planning approach. Ministerial priorities and objectives are officially established each year and are clearly communicated to senior management and responsibility centre managers. Assistant Deputy Ministers set intermediate objectives to meet ministerial priorities, and activities and action plans are established by the Posts and Branches to achieve them. Thus, the basic design of the system is appropriate, however, we identified the following problems:

- Instructions and controls within the system did not sufficiently address the completeness, quality and validity of planning information at various operational levels within the Trade function.
- The planning process did not formally consider alternative delivery options either at the strategic or operational level to achieve maximum benefit in allocating funds within the Trade function.
- There was no monitoring system to ensure adherence to plans or to collect data on the results of various activities.

9.69 **Foreign operations.** The main planning documents used to guide program activities at Posts and to inform Headquarters are the Post Work Plans. These Plans provide details on the socio-economic and political environment within which a Post must operate. They set out the Post program objectives and identify the resources to be devoted to them. Planning activities are formally conducted once a year, although priorities and goals may be informally adjusted throughout the year.

9.70 Post Plans do not reflect the complete range of tasks actually performed by Trade Officers. The Plans do not adequately distinguish between active and reactive tasks. Data outlining the Trade Officers' routine activities of responding to inquiries and assisting business representatives (which officers claim absorb more than 50 per cent of their time) are not included in the Plan. Post Plans imply that all the Trade function resources are devoted to only those activities included in the Plan. As a result, Trade activities set out in Post Plans reflect only a portion of the actual duties carried out by Trade Officers.

9.71 Posts could plan for the routine or responsive aspects of the Trade Officers' duties. In particular, estimates could be made of the number of enquiries, business visitors and other day-to-day activities. These estimates, coupled with guidelines on the level of service to be provided, would give the Posts a sound basis for determining the resources required for responsive activities and the amount available for new initiatives.

9.72 In effect, all Posts are controlled largely by business and other representational demands on their services. At Posts where demand is high and where considerable effort is made to provide the highest quality service, there is little time to follow through on the Trade initiatives proposed in the Plans. Consequently, the same initiatives are put forward each year. This gives an incorrect impression of a Post's contribution to broad Trade objectives. For example, we noted that one Post had proposed in three consecutive Plans an initiative to identify market opportunities in the agricultural machinery market sector. The officer involved claimed that virtually no activity had been undertaken in that sector because of other priorities. These facts were not available on the planning file or in the Plan.

9.73 There was no Headquarters or Post procedure to report variance from the Post Plans nor to monitor the achievement of objectives or report the degree of progress attained. The planning system presumes that current delivery processes are adequate. The purpose of the Post Plan is to communicate information to Headquarters on the current and future deployment of resources in response to departmental priorities. The Plan should include ongoing workload estimates and new initiatives with associated resource requirements. Information on ongoing workload should not increase the paper burden for Posts and Headquarters, but rather provide a more specific linkage between activities and resources.

9.74 At the Post, the formal planning system stops at the production of the Post Plan. The officer responsible for a specific Trade activity should develop a detailed action plan. This detailed plan should be maintained at Post and used as the basis for interim review of the Post Plan. Detailed plans, however, are not prepared.

9.75 The new Trade monitoring system is an improvement over the previous four years when the Department had little information on the Trade function. The features of the system are that, each month, officers at the Post record the number of activities performed and the percentage of time devoted to each type of activity. On a quarterly basis, the statistics are forwarded to Headquarters with a narrative statement of achievements. Because the system is just being implemented, it is too early to tell how useful these reports will be and to what extent they will address the problems we identified.

9.76 **Headquarters planning.** We also found weaknesses in the operational components of the Headquarters planning system. For example, the Defence Programs Bureau had not established an operational plan ranking defence marketing activities as a basis for allocating resources. Short-term activities were planned as part of the formal annual exercise, but this plan, except for a recent defence trade initiative in the United States, was not related to intermediate or long-term Defence products Trade objectives. The long lead time required in the development and marketing of these products makes it important to have a longer-term plan than that demanded by the departmental planning systems.

9.77 Although the Department was given responsibility in 1983 for managing the delivery of the Tourism program in the United States and abroad, Headquarters planning of the Tourism program remained in Tourism Canada. As a result, External Affairs Headquarters has no planning process to incorporate the objectives of the Tourism Canada program with the short or long-term objectives of the Trade function. Officers at Posts indicated that Tourism was a specialized trade sector that should be managed within the overall context of the Trade function.

9.78 **The Department of External Affairs should ensure that the Post planning system contains accurate information on all Post activities related to the allocation of the Trade Officers' work time to responsive activities and new initiatives.**

Department's response: A new planning and tracking system is being introduced, but it is important not to overemphasize the worth of "input data" *(such as workload indicators and time allocation), at the expense of "output data" (such as business influenced and other results measurements) in evaluating the effectiveness of mission activities in the trade function.*

9.79 The Department of External Affairs should monitor the activities undertaken by Trade Officers and should compare results achieved to Post Plans and objectives. Alternative delivery options should be examined in light of the resulting information.

Department's response: *(see response to 9.78)*

Procedures to Measure Effectiveness

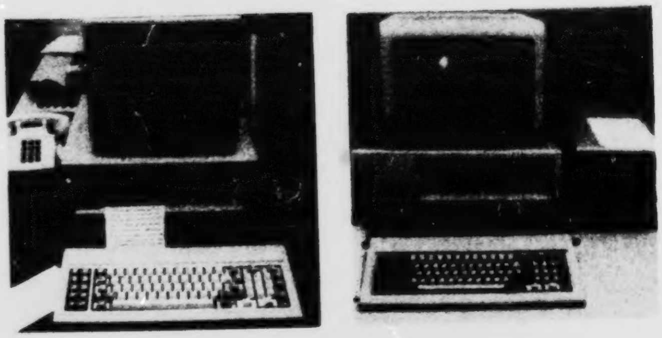
9.80 The Department's measurement and reporting of effectiveness of the Trade function is not adequate. Its evaluation plan called for only a limited amount of measurement and reporting of the effectiveness of the trade function during the period under review. Many trade activities are delivered jointly with other government departments. There are no agreements or understandings of how Trade activities will be evaluated, given the responsibilities shared with these other government departments.

9.81 The Department has not completed effectiveness evaluations of most of the Trade function. This is due in part to the lack of adequate data on operational performance. To correct this, the Evaluation Division has made a major contribution to the design and implementation of an operational monitoring system. The Evaluation Division's resources devoted to the Trade function were involved in identifying and gathering operational information. Evaluation Division plans include evaluation studies of major activities of the Trade function.

Electronic Data Processing

9.82 External Affairs has developed about a dozen different computerized information systems for the Trade function. Some of these systems were inherited from the former Department of Industry, Trade and Commerce and other government departments. In 1985-86, the Department planned to spend approximately $11 million on computer systems, a sizeable portion of which is devoted to the Trade function.

9.83 Our examination of the systems indicated little compatibility among them. For example, three new microcomputer systems (WIN-Exports, Meeting and Incentives Travel Tourism, and Post Financial Management) are being developed by three different teams that have little communication with each other. This is happening in spite of the similarities between the three systems and the fact that all could run on the same hardware. As a result, the Posts will need to acquire and maintain three different types of computer hardware to run the three systems. If one of the computers fails, it will not be possible to interchange software with another computer in the same location.



Personal Computers

Computer Terminals

Word Processors

Examples of the many different types of incompatible computer equipment used for the computerized information systems in the Department (see paragraphs 9.84 to 9.85).

9.84 As well, each system has different telecommunications requirements. This is a significant problem in a departmental communications system that is spread around the world in 121 Posts. We identified similar inefficiencies in Headquarters word processing equipment that had been purchased from six different manufacturers. Lack of compatibility has implications for increased costs of hardware, software, training and data transfer.

9.85 This situation has occurred because the responsibility for systems development has frequently been given to the unit responsible for the specific program or activity. There is little central control to ensure that the individual EDP systems development activities are being carried out in a co-ordinated manner.

9.86 The Department of External Affairs should centrally control future EDP systems development for the Trade function.

> *Department's response: The Department agrees. Over the last twelve months a number of steps have been taken to correct this situation; a very successful Office Automation pilot project has just been completed, and a major planning effort is currently under way which aims at integrating all hardware and software development activities, and at maximizing the compatibility of both existing and planned, systems, not only in the Trade area but across the Department. The Department is, as well, taking steps to rationalize the organization of the EDP function; an Information Resources Management Bureau is being formed which will bring together Management Consulting, Office Automation, EDP systems development, Telecommunications, Word Processing Services and Records Management under a single Director General. This, we believe, should eliminate organizationally-based problems of the past and also provide higher visibility to the EDP function.*

Human Resource Management

9.87 In External Affairs, line managers in the geographic branches and at Posts are responsible for determining the number of people and the skills they require to deliver the Trade function. The Personnel Branch is responsible for the recruitment, training, promotion and, through the assignment process, deployment of foreign service officers. It also provides advice to managers concerning availability of staff and staffing alternatives. To provide appropriate advice about assignments, Personnel must gather detailed information on the qualifications of individuals, position requirements, health restrictions and living conditions relative to each assignment. The result should be a matching of numbers of people required with those available, and a matching of individual skills with the specific job requirements.

9.88 As shown previously in Exhibit 9.2, the allocation of Trade Officers does not follow the pattern of trade flows. Since 1980 Canadian exports to Europe have declined while trade with Pacific Rim countries and the United States has grown. In line with stated government initiatives, there has been a steady increase in the allocation to Asia/Pacific. When looking at trade patterns over the past 15 years Europe continues to have significantly more Trade Officers than other regions. There are many possible reasons for this, including the number of Posts, the make-up of the trade flow, investment opportunities, trade in services, and so on.

9.89 The Department has undertaken "A-base" reviews at some European Posts. However, the lessons learned from these reviews have not yet been used to determine the human resources in use and needed to deliver the Trade function at other Posts. Without such an evaluation, it is difficult for the Department to conclude on the appropriateness of its stated resource needs.

9.90 Exhibit 9.3 shows the distribution of staff located in Canada and abroad. The Canada based staff are part of the rotational foreign service. The locally engaged staff are employed by the Department at specific Posts. They are not part of the Canadian public service. Personnel Branch is responsible for the staffing of positions for Canada based positions, whereas Posts are responsible for staffing locally engaged positions. Depending on the Post, a rotational employee is assigned to a Post for a two- to four-year period. This may be extended an additional year. After an assignment, the employee may return to Canada or be assigned to another Post. More than two consecutive assignments to Posts is not common practice. Also, with the exception of difficult language Posts, it is unusual that an employee would be assigned to the same Post twice during his or her career.

9.91 **Human resource planning.** Operational plans do not provide sufficient information to forecast human resource requirements. The plans do provide an estimate of the number of person-years by level required in each branch and Post; however, they do not provide any information on the skills needed to complete the tasks identified. Assignment officers determine the level of skill required, based on their knowledge of the function. More detailed job and skill information would improve the matching of personnel to jobs in the assignment process.

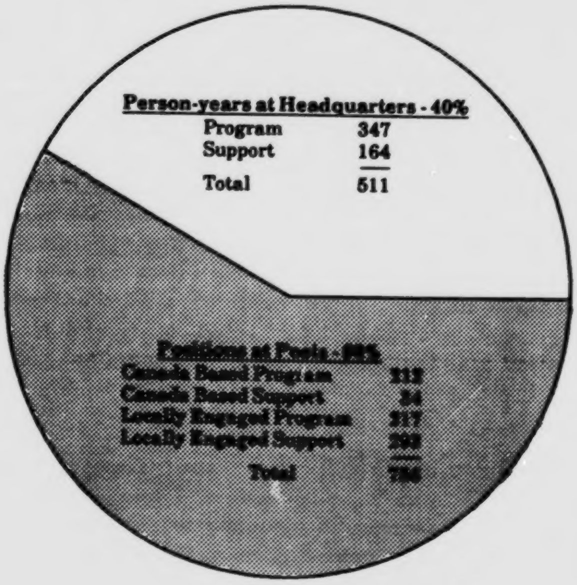
9.92 The information available in the personnel information system is limited to tombstone data and assignments for the last two years. Although originally intended to be used in the assignment process, the computerized personnel information system is not used by assignment officers. To provide better and more current information on employees, the assignment officers have been inputting data on a microcomputer. These computerized records are not yet complete, but they have been used by assignment officers during the current posting cycle. The microcomputer is used to produce a short list of potential candidates. In this process, the determination of relevant skills is not made until after the short list is prepared. Consequently, potential candidates with more relevant skills may not be considered.

9.93 Once the short list is prepared, the final steps of the selection process are well done. The assignment officers use the appraisal system, which is universal in the Department, to obtain performance information, and discuss candidates with appropriate line managers to arrive at a final selection.

9.94 **Locally engaged commercial officers.** Because the Post is responsible for staffing locally engaged positions, the assignment officer does not consider the qualifications of the locally engaged staff when assigning Canada based personnel. The Post is assumed to have taken account of the qualifications of the locally engaged staff when it requests Canada based staff.

Exhibit 9.3

EXTERNAL AFFAIRS' ALLOCATION OF TRADE STAFF



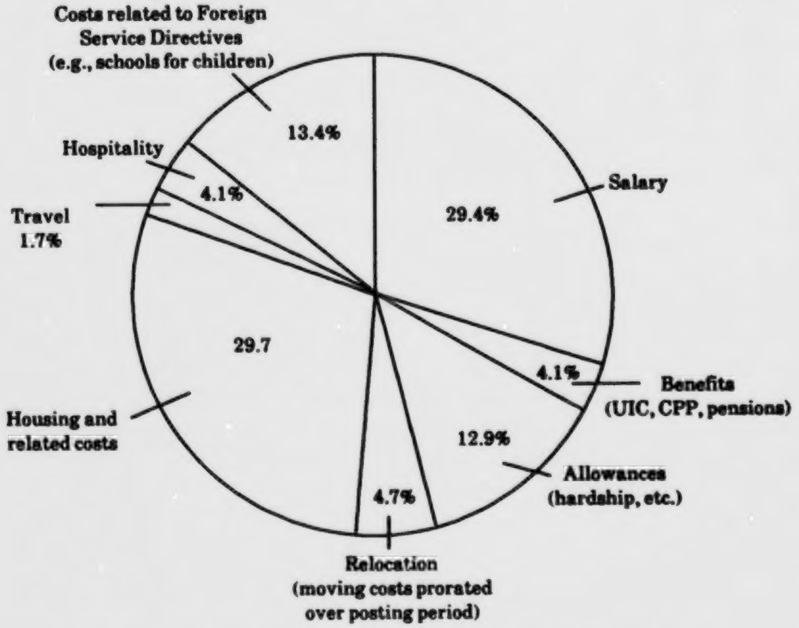
9.95 In many locations it is difficult to distinguish the tasks to be carried out by Canada based officers (FS-1 and FS-2) from those of the locally engaged commercial officers. Further, locally engaged staff may possess specialized skills that need not be duplicated by Canada-based officers. However, security considerations, conflict of interest, and factors of access to local government officials limit the extent to which locally engaged commercial officers may be substituted for Canada based staff. As Exhibit 9.4 shows, the cost of maintaining a Canada based officer in a Post is significantly higher than maintaining a locally engaged officer. This may range from 3 to 16 times more expensive. To ensure due regard for economy, appropriate program coverage and experience opportunities for Canada based officers, it is important that the Post maintain the proper mix of Canada based and locally engaged officers. Managers do not have guidelines or policy direction for employing locally engaged officers instead of Canada based officers.

9.96 **Training.** Because of its rotational workforce, the Department has unique training needs. Employees are recruited as generalists and tend to acquire their skills on the job. Because an assignment is for only two to four years, and because the nature and variety of tasks change from assignment to assignment, it is important to ensure that appropriate training takes place so that the highest level of performance can be obtained. Further, rotational assignments make it difficult for officers to maintain continuity in performing tasks and to keep abreast of change. Thus, officers need to be updated on current departmental and industry practices when returning from assignments abroad.

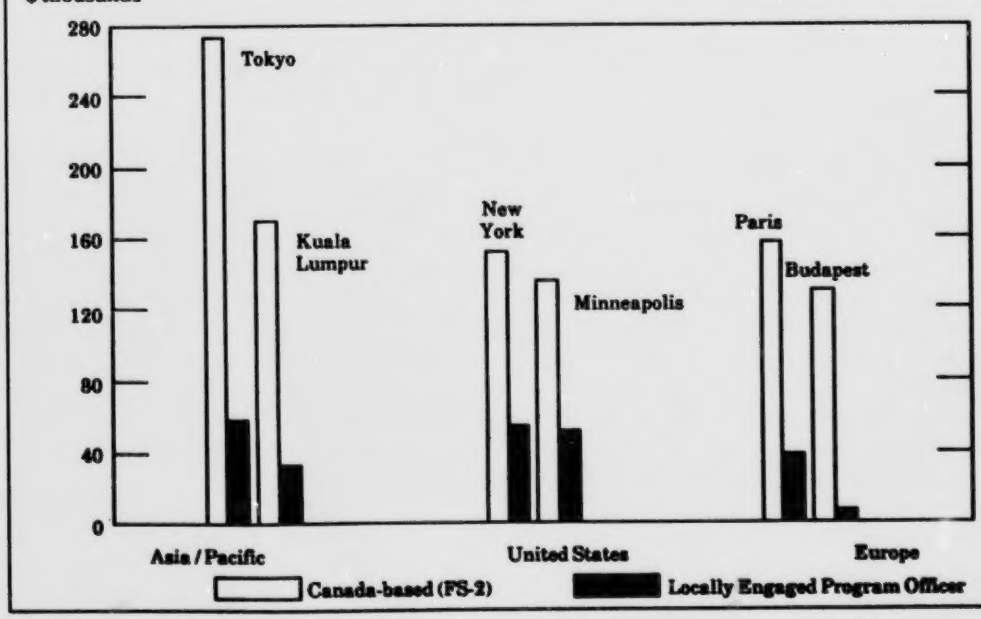
Exhibit 9.4

COST OF MAINTAINING PERSONNEL ABROAD

Estimated breakdown of costs for a senior Foreign Service Officer (FS-2)



Comparison of Cost Estimates for Canada-based and Locally Engaged Staff



9.97 Some of the tasks within the Trade function require a specialized knowledge of a sector or commodity not normally expected of a generalist. When the amount of work associated with the task approaches or exceeds a person-year, it may be more efficient to use a specialist, seconded from another government department, than it is to use a generalist. Specialists like Science and Technology advisers are used in some traditional locations. The Department estimates its needs for specialists through the Post planning exercise. Those needs are discussed interdepartmentally and secondments are arranged.

9.98 Nevertheless, situations arise where it is necessary to use a generalist for a task requiring specialist knowledge. Under such circumstances, generalists need basic training in the specialization and procedures to obtain specialist advice at appropriate times. Such training is not consistently provided. For example, although Defence Products is a specialized area of expertise and has specific positions identified at Posts, no special training is provided, and the Department recently has not recruited specialists in Defence Products marketing.

9.99 Although the amount of training provided by the Department has increased as a result of line managers' responses to a training needs survey, the overall need for training within the Department has not been determined. There is a need to assess short- and long-term training needs based on current and future operational requirements. We noted specific problems that could be corrected through training – in turnover procedures during the assignment process, documentation procedures at Post, and the management and analysis of trade data. Although there is some pre-posting training, it is carried out in an ad-hoc fashion on the initiative of the officer being posted. There is no overall policy on the training to be given prior to assignment abroad. Consequently, there are large variations in work practices, resulting in inefficiencies in turnover procedures and lack of continuity in the approach to specific problems.

9.100 The Department of External Affairs should establish a clear human resource management policy for Trade Officers, including those engaged locally. The policy should include references to the use of specialists, and to the training of all officers.

> *Department's response: The Department has developed a multi-year human resource plan dealing with all streams, including Trade. Over the last year, significant improvements have been made in the methods of selection and training of officers. The Department will endeavour to increase the level of secondments from other departments (already the largest such program of any department) which should provide increased specialist capability. The Department of External Affairs also plans to increase the level of interchanges with the private sector. Career management of locally engaged Commercial officers will be addressed within the constraints and limited advancement potential which are an inevitable feature of this group. The Department has, moreover, improved training of Commercial officers and intends to increase the frequency of familiarization tours of Canada should budgets permit.*

9.101 The Department of External Affairs should develop information systems that facilitate matching employee skills with up-to-date job requirements during the assignment process.

> *Department's response: Information systems are being refined to ensure a more comprehensive identification of position requirements and employee skills.*

Cost Recovery

9.102 Some services are carried out by Trade Officers in response to specific requests from individual companies seeking assistance to enter a foreign market. These services are expensive to maintain and not available through any other source. In respect to this type of service, the Guide on Financial Administration states that "...services to persons... are services of public importance rendered by the government to individuals or groups of individuals, either at their request or arising from their actions.... Since these services are usually rendered at the option of identifiable individuals or groups of individuals, the cost of these services should be borne by them." With one exception, there is no charge for the cost of the services provided to individuals or companies. The exception is the direct out-of-pocket cost of obtaining publicly available financial reports concerning specific companies at the request of a Canadian business representative.

9.103 To demonstrate the cost of staff abroad, we prepared Exhibit 9.4. It shows, for the three main regions, the maximum and minimum costs of maintaining a Canada based officer at a Post compared to the cost of a locally engaged officer at the same Post. These costs are based on a departmental costing model that includes salary, benefits, foreign service benefits, hospitality, travel and accommodation costs. The most expensive location for a Canada based officer is Tokyo, at $274,515 a year; the least expensive is Quito, at $128,420 a year. The salary and normal benefits for officers remain constant; what varies is the specific location costs, especially accommodation. The pie-chart of exhibit 9.4 shows the approximate distribution of the costs of Canada based officers abroad.

9.104 Canada based officers in the Embassies, High Commissions and Consulates General are well placed to gain access to important business and government contacts in other countries. However, there are risks that they are not being used in the most effective way because of the significant demands for service being placed on them. Given the importance of companies being well prepared to approach foreign markets, and the limited resources available to the Trade function abroad, partial cost recovery could be viewed as a means of imposing additional rigour on individuals or organizations requesting the services of an Embassy, such as in-depth market research or a number of visits to the Embassy exceeding a reasonable level of service. The load on Trade Officers at Posts could be further reduced if business representatives were to use the DRIE regional offices as a point of first contact before approaching foreign markets and the more specialized services of the Embassies.

9.105 The work of the Posts is important to the expansion of Canadian trade throughout the world. The demand for these services is high and likely to increase in the coming years. Given the labour-intensive nature of many of the services being provided by Posts, the need to maintain a high quality of advice and information, and to continue a high level of professionalism, it is our opinion that the value of and demand for such services is capable of sustaining, and would justify, a measure of cost recovery. This is a procedure that has been employed by other countries in delivering their international trade programs.

9.106 The Department of External Affairs should examine the Trade function from a cost-recovery perspective and make appropriate recommendations to the government.

> *Department's response: Increased cost recovery is being considered in relation to the Promotional Projects Program. The Department is also recovering some of the cost of sectoral brochures from participating industries. The Department will continue to look for opportunities for further cost recovery where practical and where this action would not be a deterrent to the marketing efforts of small and novice exporters.*

External Affairs Canada
Affaires extérieures Canada

Associate Under-Secretary
Sous-secrétaire associé

August 8, 1986

Mr. Kenneth M. Dye
Auditor General of Canada
Office of the Auditor General
of Canada
240 Sparks Street
Ottawa, Ontario
K1A 0G6

Dear Mr. Dye:

I am writing to you about your audit report on the trade function in the Department of External Affairs. In doing so, I would like to put on the record some general points about the report that do not come through in the detailed responses.

At the outset I should say that the Department appreciated the smooth way the audit was conducted, and welcomed the many opportunities to discuss the report with your staff.

My primary concern is that the emphasis on process and procedure in the report does not get at the real issue: the Department's effectiveness in trade policy and trade promotion. Your auditors have been much more forthcoming and positive about the Department's performance in oral discussions than in the written report. They appear to share the views of the trade program's business clientèle concerning the high level of effectiveness of our trade officers abroad, and they have acknowledged the very significant progress made in trade program planning, monitoring and reporting over the last two years. It would have been welcomed if some of these comments had been reflected in the formal report.

I had expected the report to reflect more fully the current resource environment in government. We, along with others, are trying to do better with less and, as a result, are acutely sensitive to prudent management of trade program resources. Reductions have been made in support of the Government's restraint program. Redeployments have been made in favour of high priority trade activities and regions. A large number of new initiatives have been undertaken. These measures have required continual and detailed scrutiny of the Department's trade resources by me and my colleagues, contrary to the direct implication made in your report that we are somehow unable to decide on the appropriateness of our stated resource needs (9.90).

.../2

125 promenade Sussex Drive
Ottawa, K1A 0G2

The report puts considerable emphasis on the need for more guidelines and frameworks to govern interdepartmental operating relationships and to control the services to business offered by posts abroad. I am not convinced that we should be adding further written controls on the trade program. There is little evidence that this would be a useful supplement to the experience, judgment, and expertise of trade program officers, and your report sheds no light on what additional program results would be achieved or what deficiencies would be corrected by the introduction of more administrative structures. I have also to be concerned about the administrative costs in both time and resources that additions to the Department's already significant structure of formal guidelines and coordination frameworks would entail, especially as your report does not indicate that these alleged shortcomings are anywhere reflected in a lack of program effectiveness.

To sum up, the report appears to be dominated by the assumption that good management necessarily means even more measurement of program activity and input. We are making adjustments and will continue to do so in order to ensure that our trade promotion and trade policy activities continue to serve Canadian producers and Canadian interests. Several of the report's recommendations are already being implemented. My colleagues and I, however, believe that our basic planning and measurement systems are adequate and that there is now a need instead to concentrate on program results and outputs. The real management challenge in this Department is now to ensure the triumph of product over process.

Sincerely yours,

DHBurney

D.H. Burney

DEPARTMENT OF FISHERIES AND OCEANS
PACIFIC AND FRESHWATER FISHERIES

DEPARTMENT OF FISHERIES AND OCEANS
PACIFIC AND FRESHWATER FISHERIES

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10

DEPARTMENT OF FISHERIES AND OCEANS PACIFIC AND FRESHWATER FISHERIES

Introduction

10.1 The Department of Fisheries and Oceans carries out the federal government's responsibilities for sea coast and inland fisheries. The primary objective of the Department is to protect and conserve fish. The Department also aims to maintain and develop the economic and social benefits of the fisheries through proper management and regulation of the fisheries.

10.2 We are conducting the value-for-money audit of the Department of Fisheries and Oceans in two phases. The first phase concentrated on the Pacific fishery, and the second phase, to be reported in 1988, will focus on the Atlantic fishery. The Department spent over 80 per cent of its $643 million budget in 1985-86 in these two areas. In this first phase we have also reviewed the delegated arrangements that the Department has made with some provinces to manage the freshwater fisheries.

Audit Approach: "Where the Net Hits the Water"

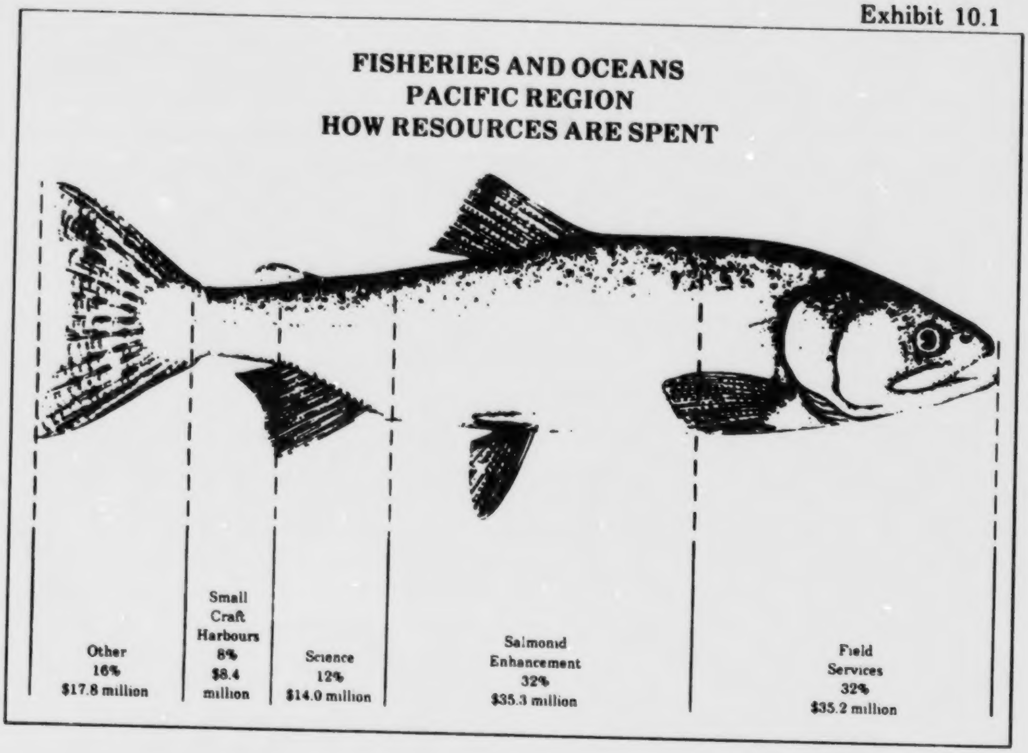
10.3 Our audit of the Pacific Region concentrated on the key operational activity of the Region - fisheries management. The primary thrust of the audit was to examine how the Department manages the fishery at the point where critical fish management decisions are made; that is, where the nets hit the water.

10.4 We concentrated our audit work on the management of the two most valuable species groups in the Pacific fishery - salmon and herring. These represent about 80 per cent of the value of the fishery. We audited four major areas.

10.5 First, the Pacific fishery has repeatedly experienced severe economic problems over the past 30 years, and the Department has encountered considerable difficulty in limiting fishing so as to protect fish stocks. We reviewed the regulatory framework of the Pacific fishery and particularly the efforts of the Department and the government to improve the management of the fishery.

10.6 Second, a large part of the Department's expenditures involves field operations or in-season fisheries management. This is the backbone of the day-to-day activities of the Region. We reviewed the quality of information that regional managers have at their disposal to make decisions on who should fish, where and for how long. We also reviewed the degree to which this function is carried out economically and efficiently.

Exhibit 10.1



FISHERIES AND OCEANS
PACIFIC REGION
HOW RESOURCES ARE SPENT

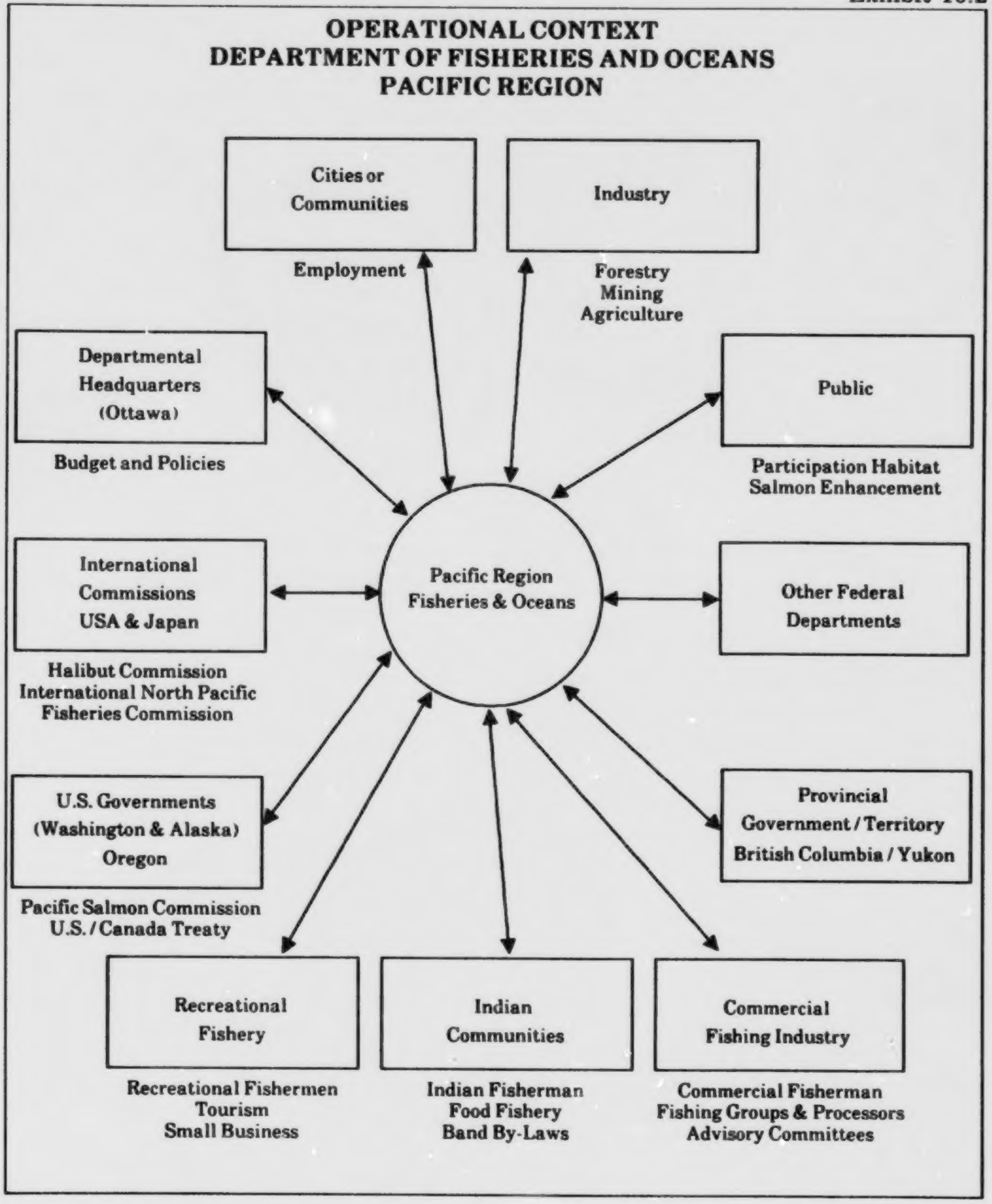
10.7 Third, the Salmonid Enhancement Program is of particular importance to the Pacific fishery. It has been responsible for over $250 million in expenditures over the past nine years to rebuild stocks of salmon and improve or protect the habitat of the salmon. We assessed how the Region was monitoring the effectiveness of the program and its progress on cost recovery.

10.8 Finally, to determine how the Region managed its total 1985-86 budget of over $110 million and 1,306 person-years to accomplish its operational functions, we audited the planning and budgeting system of the Region and the management practices of various administrative and technical support functions.

The Context of the Pacific Fishery

10.9 The Pacific fishery is characterized by many groups competing for a scarce resource. The Region operates in a complex environment composed of recreational and commercial groups that demand a share of the resource, Indian people who have traditionally fished salmon and herring, and a variety of other interested parties including industry and local communities. The Region must also co-ordinate its activities with a number of other federal departments such as Indian Affairs and Northern Development, Transport (Coast Guard) and the Department of the Environment. In addition, co-operation is also required with the government of British Columbia and other countries.

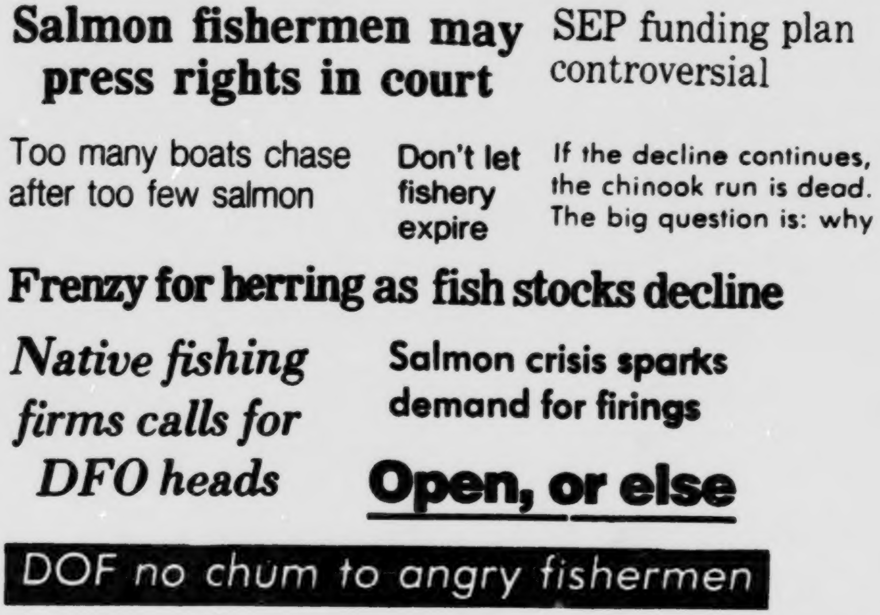
Exhibit 10.2



OPERATIONAL CONTEXT
DEPARTMENT OF FISHERIES AND OCEANS
PACIFIC REGION

Cities or Communities
Employment
Industry
Forestry
Mining
Agriculture
Departmental Headquarters (Ottawa)
Budget and Policies
Public
Participation Habitat
Salmon Enhancement
International Commissions USA & Japan
Halibut Commission
International North Pacific Fisheries Commission
Pacific Region Fisheries & Oceans
Other Federal Departments
U.S. Governments (Washington & Alaska) Oregon
Pacific Salmon Commission
U.S. / Canada Treaty
Provincial Government / Territory British Columbia / Yukon
Recreational Fishery
Recreational Fishermen
Tourism
Small Business
Indian Communities
Indian Fisherman
Food Fishery
Band By-Laws
Commercial Fishing Industry
Commercial Fisherman
Fishing Groups & Processors
Advisory Committees

10.10 For managing the fishery, the Region has established consultative processes and committees at the international, regional and district levels. These include committees to deal with specific fishing areas such as the south coast, central coast and Skeena. In addition, there is a Minister's Advisory Council that advises the Minister on a range of issues including the overall allocation of catch among the various groups involved in the Pacific fishery. This Council is intended to be broadly representative of fishing interests in the Pacific fishery.



Salmon fishermen may press rights in court

SEP funding plan controversial

Too many boats chase after too few salmon

Don't let fishery expire

If the decline continues, the chinook run is dead. The big question is: why

Frenzy for herring as fish stocks decline

Native fishing firms calls for DFO heads

Salmon crisis sparks demand for firings

Open, or else

DOF no chum to angry fishermen

This collection of newspaper headlines illustrates the controversial nature of the Pacific fishery.

10.11 Because of the difficulties of obtaining consensus among the various commercial fishing groups, and among the commercial, recreational and Indian interests, a considerable amount of senior management attention has been devoted to obtaining agreement on how to manage the fisheries each season. To balance Indian fishing concerns with the Department's responsibilities for managing the fishery, the Department has been moving toward co-management of stocks with some Indian bands.

Management Challenges

10.12 The Pacific Region is faced with management challenges to:

- deal with the cyclical economic malaise in the fishing industry – overcapacity of the fleet, high debts and uncertain incomes;
- reverse the gradual decline of natural stock levels and achieve optimal escapement levels; that is, maximum numbers of salmon that escape to spawn;
- resolve the problem of allocating fish among competing fishing interests (commercial, recreational, Indian);
- respond to the demands and needs of the native community with respect to allocating and managing fish stocks on or near Indian reserves;

- adapt to the requirements of the U.S./Canada salmon treaty, which includes an agreement on stock rebuilding, conservation initiatives, information exchange and enforcement; and

- manage the Region in a time of increasing resource restraint and government cut-backs, and, at the same time, respond to new demands for resources.

10.13 Many of these challenges involve the relationship between the Department and its various publics. Because of the difficulties in obtaining consensus on regulating the fisheries and allocating the fish catch among the various fishing groups, this often requires active ministerial involvement in establishing policies, priorities and agreements. Over the past few years, the Region has been faced with changes of ministers, deputy ministers, and regional directors general as well as a series of organizational changes at the regional and headquarters levels. These changes have contributed to instability in the Region and have made it difficult for the Pacific Region to focus clearly on priorities, to initiate policy changes, and to make management improvements.

The Pacific Region: A General Assessment

10.14 The Pacific Region is currently faced with two major problems – improving the overall management of the Pacific fishery and managing its resources (people, money and equipment) more efficiently and economically.

10.15 In the Pacific Region, there are significant challenges in managing and protecting fish. The overcapacity of the fishing fleet, combined with over-investment and uncertain incomes for some fishermen, has caused the participants in the fishery to put pressure on the Department to allocate a larger portion of the available fish to them. It has also made fisheries management more difficult, complex, and expensive. Under the current regulatory and management framework of the Pacific fishery, there are no plans, priorities or agreements in place that will enable the government and the industry to avoid the recurring economic problems that the fishery has experienced in the past, the attendant pressures for government expenditures and the need for stock information to keep pace with the changing fishery.

10.16 The Region has done a creditable job of managing the fishery, given the complexity and difficulty of the job. However, in doing so, it has relied to a large extent on the knowledge and dedication of its staff as opposed to developing management practices and information that will allow it to keep pace with the changing industry and to support fishery officers in managing the fishery. For example, although the primary purpose of the Region is to protect fish stocks from over-exploitation, the critical information required on stocks is inadequate.

10.17 The Region also needs to improve its management of financial, materiel and human resources. This includes a need for better planning and allocation and better acquisition and use of equipment. The Region does not ensure that its resources are directed to priority tasks or that they are managed economically and efficiently. It needs to improve significantly its overall planning and budgeting system and its management of expenditure areas such as boats, engines, communications equipment, contracts and computers.

The Regulatory Framework of the Pacific Fishery

The Problems of the Pacific Fishery

10.18 The Pacific fishery is one of the world's most valuable fishing resources. The average annual wholesale value of the salmon fishery for the past 12 years was $253 million, and the average wholesale value of herring was $89 million in the same period. The fishery employs approximately 20,000 people (part-time and full-time) in harvesting and processing activities in British Columbia, and fishing is the major economic activity in over 40 communities in the province. In addition, over 400,000 licensed recreational fishermen participate in the salt water fisheries. Recreational fishing is an important part of the tourist industry. A significant number of the 55,000 status Indians in the province depend on fish for a living or as a traditional food source.

10.19 In the past five years, several important commissions or task force reports have identified major problems in the Pacific fishery. The most comprehensive of these studies was conducted by Dr. Peter Pearse who headed the Pacific Fisheries Commission. His report, *Turning the Tide: A New Policy for Canada's Pacific Fisheries, 1982*, stated that a fundamental problem facing the Pacific fishery was too many boats chasing too few fish. In addition, the single most fundamental criticism that he had was that the Pacific fishery lacked an overall policy or plan to guide fisheries management.

10.20 Other studies and reports have reiterated some of the same problems as those identified by Pearse. For example, reports from the Economic Council of Canada, the Minister's Advisory Council for the Pacific Fisheries, the Royal Commission on the Economic Union and Development Prospects for Canada, 1985, and the Ministerial Review of Program Expenditures 1986, have reinforced Pearse's findings.

10.21 These reports identified the need to address four persistent and aggravating problems in the Pacific fishery:

- the problem of the excess capacity of the fleet;
- the problem of overfishing and the need to rebuild stocks;
- the inefficiency of the overall regulatory and management framework; and
- the cyclical economic problems of the fisheries fleet, such as overinvestments, uncertain incomes and high debts.

Managing a Common Property Resource and The Problem of Overcapacity

10.22 One of the most important factors that contribute to the problems of managing the Pacific fisheries is the common property nature of the resource.

10.23 Unlike forestry or agriculture, where individuals have rights to harvest a resource in a particular area, fish migrate over thousands of miles and are regarded as a free or common resource that can be harvested by any licensed fishermen. Fishermen are generally regulated by the type of gear and boats they use, the days they can fish, or the area where they are allowed to fish. However, within these restrictions, commercial fishermen compete to catch as many fish as they can in a common area. Under this common property framework, fishermen have no incentive to protect or conserve fish when they can be caught by other fishermen. This makes regulation a vital and important feature of the fishery.

10.24 The implications of harvesting fish under common property conditions are that fishermen, in order to remain competitive, invest heavily in boats and equipment. For each fisherman, this is a rational approach, but for the fishery as whole it results in over-investment, uncertain incomes, high debt and excessive catching ability. In response to this problem, the Minister's Advisory Council recommended in 1983 a $100 million buy-back program, partly funded by fishermen " to relieve the pressure on an over-fished resource and increase escapements to the spawning grounds by buying out excess fishing capacity."

10.25 Over the past 15 years the number of fishing boats has been reduced from 6,600 to 4,400. However, the catching capability of the total fleet has increased dramatically through upgrading vessels under existing licences or by technological improvements. In this period, fishing vessels have added sophisticated gear to find, catch and store fish. Because of the enormous catching capacity of the current fishing fleet, the number of fishing days allowed for various gear types has been curtailed severely. For example, the 1986 herring fishery was open an average of 15 hours in three areas and the 1985 salmon fishery was open for only 46 calendar days for 550 seine boats.

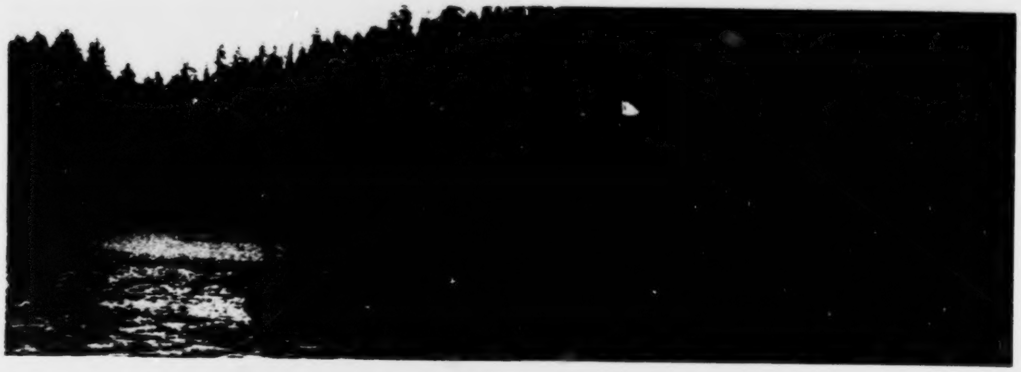
The Pacific Fishery: Low Returns and High Costs

10.26 The studies and reports on the Pacific fishery generally agree that the present approach to managing and regulating the fisheries has not generated nearly as many total benefits as it could. The level of investment by fishermen to harvest the resource is very high in relation to the value of the catch, and the Department's operational costs of managing and regulating the Pacific fisheries are over $100 million.

10.27 The paradox is that in one of the world's most valuable fisheries, neither the fishermen nor the taxpayers are achieving the potential benefits of this resource. To illustrate this point, the Pearse Commission estimated the potential average annual natural stock levels that the ocean and streams could support biologically. To give these estimates some economic perspective, we converted this potential biological yield into a wholesale value and assumed current product mix and average prices. On this basis, the potential annual increase in wholesale value would be somewhere between $300 million and $700 million. This does not include the potential from enhanced salmon.

10.28 The reasons for the relatively high cost of managing the fishery and the low rates of return to fishermen on their investments are as follows:

With the advent of the hydraulic drum in the 1960s and other technological improvements, a seine boat can now set a net in under 20 minutes day or night. This has dramatically increased the catching capacity of these boats (see paragraph 10.25).



One of the 550 seine boats that catch over 40% of the annual volume of salmon (see paragraph 10.25).

- The high level of investment in fleet capacity in relation to the value of the fisheries resource makes it difficult for fishermen to earn an adequate return on their investment income and creates financial difficulties when there are poor fishing seasons, price declines, or interest rate increases.

- Faced with a massive fishing fleet, it is much more difficult for the Department to monitor the fisheries and protect or conserve the fisheries resource. Because of the catching capacity of the fishing fleet, a day of additional fishing can result in over-fishing. Thus, the risk of over-fishing has increased substantially in the past decade.

- The large capacity of the fleet and the uncertain returns to some fishermen create considerable pressures for the allocation process (that is, decisions on allocating catch among fishing groups). This requires the commitment of considerable resources and time at all levels of the Department.

10.29 The problem of over-fishing and declining natural stock levels is one of the reasons why the government has funded the Salmonid Enhancement Program to rebuild stocks through habitat improvement and enhancement. In addition, to respond to the increased pressures on the fish resource, the Department requires better and more timely information and improved surveillance and enforcement activities.

10.30 As a result of these characteristics of the Pacific fisheries, the total processing and harvesting costs (boats, fuel, employees, plants, and equipment) and the government costs of the fishery are approximately equal to the value that the fishery produces. Thus, under the current management and regulatory framework, the average fisherman, the government, and the taxpayer are barely breaking even with this valuable resource.

Management Requirements in the Pacific Fishery

10.31 Because of the continuing cyclical problems that have faced the Pacific fisheries and the excess capacity in the fishing fleet, we expected that the Department would have:

- established with the fishing industry a clear framework or approach for determining how it would achieve its objective of maintaining the economic and social benefits of the fishery in both the short and long term;

- developed adequate measures to assess the growth in catch capacity and the impact of key factors on capacity increases; and

- devised options or alternatives for managing the fisheries in a way that was more economical in terms of government expenditures.

10.32 The Department and the Region need to address some of these critical requirements for managing the Pacific fishery, as discussed below.

Department Initiatives

10.33 In response to the Pearse Report, the Department developed in 1983 and 1984 extensive analyses of the problems of the Pacific fisheries as well as policy and legislative proposals. However, the proposals did not generate sufficient agreement in the fishing industry to permit the proposals to be implemented.

10.34 One area where the Region has been able to initiate important changes is in the regulation of the herring fishery. In the early 1980s, the Region introduced area licensing. This has helped the Region to regulate the herring fishery by reducing the overall number of boats and catching capacity that participated in each area fishery.

10.35 To increase stock levels, the Region has continued to support the Salmonid Enhancement Program and has developed proposals for Phase II of this program. The Region has also taken major steps in the past two years to protect or conserve fish by developing an overall plan for managing salmon and by initiating a stock assessment process.

Areas the Department Should Address

10.36 **Priorities and strategies.** To address some of the key cyclical problems facing the fisheries, the Department and the government need to develop and implement plans or directions, in consultation with the fishing industry, that would reduce the capacity problem and help to manage the fishery more economically.

10.37 One of the persistent problems of making changes to improve fisheries management is the boom and bust cycle of the fishery. In good fishing years such as the 1985 fishing season, fishermen are preoccupied with earning a living and investing in new equipment in anticipation of future catches. Hence, there is little pressure or agreement to initiate major changes. In poor fishing years, fishermen are faced with so many economic problems that it is difficult to make changes without major increases in government spending, such as buy-back programs.

10.38 Because the management of the Pacific fishery relies to a considerable degree on industry consensus, changes in the management of the fisheries have to be gradual and incremental. An adaptive approach, based on clear priorities and directions, would enable the Department and fishermen to experiment with changes without causing major disruptions to the fishing industry.

10.39 Although the Department, in response to the Pearse Report, developed proposals to improve the management of the fishery, the key recommendations regarding fleet rationalization have not been implemented. The Department currently does not have a set of priorities or strategies to address the fundamental and cyclical problems faced by the Pacific fishery as a result of fluctuating stock levels and excess catching capacity.

10.40 **Monitoring the costs and benefits of the Pacific fishery.** The Pacific Region does not have overall measures that clearly indicate the net benefits produced by the Pacific fishery. By estimating and reporting the benefits of the fishery, which are measurable, and the costs of harvesting and managing it, the Department would be in a better position to determine the degree to which it is achieving its objective of maintaining and developing the economic and social benefits of the fisheries resource.

10.41 **The Pacific Region should maintain and report measures that indicate the overall economic and social benefits of the Pacific fisheries. Measures that indicate the net benefits produced by the fisheries (for example, value produced in relation to industry and government costs) should be published periodically.**

> *Department's response: Agree. In progress. The Region has acted to increase its reporting of economic and social benefits of the Pacific fisheries. The results in general will be reported in Part III of the Estimates. The required information has been consolidated in a Corporate Review and will be in a new Fisheries Fact*

> *Sheet. There are continuing projects to annually monitor commercial fisheries costs and earnings and SEP costs and benefits by key program component. These and other less frequently updated studies and publications will provide a measure of value produced in relation to costs.*

10.42 **Tax expenditures.** Our interviews with fishermen and the Department's own studies indicate that one of the factors that encourages increased fishing capacity is the accelerated capital cost allowance (ACCA). This tax provision allows fishermen to depreciate the full cost of new vessels or equipment on an accelerated basis over a four-year period. Department studies indicate that the ACCA provisions encourage fishermen, with relatively high incomes, in good fishing years, to invest in increased fishing capacity. The figures that are available for 1981 to 1983 indicate that this tax provision was responsible for $30 million a year in tax deductions for the Pacific fishery.

10.43 Although the ACCA tax provisions encourage the expansion of fleet capacity, the Department and the fishing industry have argued that vessel capacity should be reduced by up to 30 per cent through measures such as buy-back programs. In the past few years, the Department developed several options to deal with ACCA that would require changes to the Income Tax Act. The proposed changes have not been implemented.

10.44 **The Department and the Pacific Region should review and monitor the implications of factors, such as the accelerated capital cost allowance, that are contributing to problems related to fishing capacity.**

> *Department's response:* *Agree. Pacific Region has been actively addressing this issue since before 1980. However, as it conflicts with policies of other departments DFO has been unsuccessful at resolving this issue. Pacific Region will continue to review and monitor the implications of factors which contribute to problems relating to fishing capacity. Factors such as the accelerated capital cost allowance will continue to be reviewed cyclically. Pacific Region uses a Financial Impact Simulation Model to evaluate the impacts of changes in such factors. Studies, such as that on investment behaviour of trollers conducted in 1985/86 and the five-year financial performance of the fleet under way this year, provide input data to the model for improved accuracy and for testing.*
>
> *The first new report on factors affecting fishing capacity will be completed in 1986/7.*

10.45 **Vessel capacity information.** We found that vessel information and measurements on the relationship between vessel capacity and stock levels need to be improved.

10.46 The Region has little information on the catching capability of the fishing fleet. Although it is very difficult to establish reliable measures of catching capability because of differences between the abilities of fishermen to catch fish and the evolution of technology, there are some measures that can assist the Region to accomplish this task. One way to improve this information is by volumetric measures which determine the volume or carrying capacity of boats rather than just their length. Both the Pacific Region and the Minister's Advisory Council have identified the need to have these volumetric measures, but they have not been implemented.

10.47 **The Region should, to the extent possible, develop indicators to determine excess fleet catching capacity. Volumetric measures should be implemented immediately to help the Region improve its fleet information.**

> *Department's response: Agree. The proposal is supported by DFO and all sectors of the commercial fishing industry. The question of whether government and/or industry should pay for the fleet survey has delayed its implementation. The Region will implement the proposed volumetric measures as soon as the source of funding can be decided. The project will cost about $1.0 million and will take about one year to complete. An implementation plan has been prepared. Most of this activity will be done on contract.*

Fisheries Management: Salmon and Herring

10.48 The cornerstone of managing the Pacific fisheries is the regulation of the salmon and herring fisheries. This is known in the Region as the in-season fishery. The most critical aspects are the promulgation and enforcement of the regulations surrounding the right to fish - who can fish with what gear and when. This involves the most fundamental objectives of the Department - conserving the resource and ensuring economic and social benefits from the fishery.

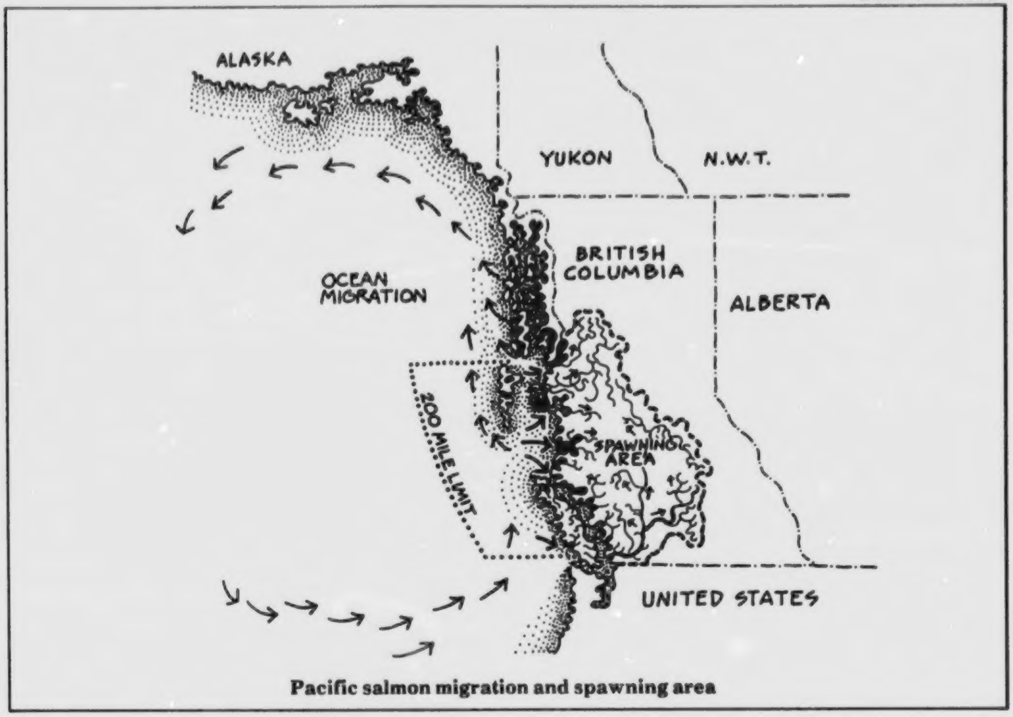
10.49 We reviewed the major aspects of managing these fisheries: the quality of information available, and the efficiency and planning of the in-season fishery.

Managing a Salmon Fishery

10.50 The management of a salmon fishery is based on the biological reproduction cycle and migration patterns of the salmon. The five species of salmon in the Pacific fishery spend most of their adult lives in the ocean and then return to thousands of freshwater streams to reproduce (Exhibit 10.3). During this migration or salmon "run", commercial, recreational and Indian fishing groups harvest the resource.

10.51 The major task of fisheries management is to ensure that sufficient numbers of salmon return or "escape" to their original spawning grounds to reproduce. Hence, an escapement target (the number of salmon that should return to spawn) is usually established for most major stocks.

Exhibit 10.3



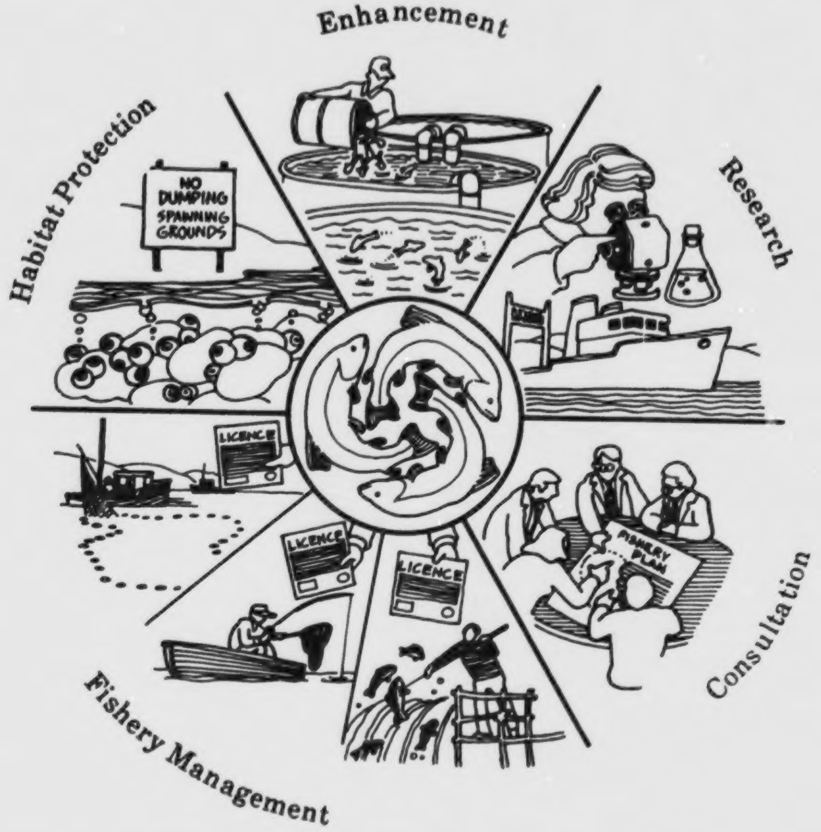
Pacific salmon migration and spawning area

10.52 Salmon fisheries are managed from many district and sub-district offices throughout British Columbia. During the fishing season, the District Supervisor sets the opening and closing times for the fishery, supervises enforcement and information gathering activities, and meets with fishing groups. Scientists provide necessary advice and assistance to the District Supervisors in setting escapement targets, estimating the size and timing of the salmon migration, and determining openings and closings.

10.53 In addition to managing the openings and closings, fishery officers are expected to conduct a variety of other tasks related to managing the resource (see Exhibit 10.4). This requires a considerable amount of time and skill in developing the next year's fishing plan with the various fishing interests, protecting the habitat from logging, mining or natural damage, and assessing the spawning beds.

10.54 In-season fisheries management is intense, complex and difficult. Decisions that have major economic implications for fishermen or for the resource often have to be made quickly and without much information. These depend to a considerable extent on the knowledge and experience of fisheries managers. For example, it is hard to determine the total number of salmon returning or the escapement levels. In peak periods, one or two days' fishing can easily make the difference between meeting or not meeting escapement targets. Consequently, fisheries managers are frequently required to make important decisions in a 24-hour period on the basis of limited information.

Exhibit 10.4


Enhancement
Research
Consultation
Fishery Management
Habitat Protection
NO DUMPING SPAWNING GROUNDS
LICENCE
LICENCE
LICENCE
FISHERY PLAN

SALMON RESOURCES MANAGEMENT CYCLE

10.55 A major feature of the in-season fishery is the interaction between fisheries managers and fishing groups. Groups pressure the Region and the Minister for additional fishing time or for a greater share of the catch. The onus is then on fisheries managers to demonstrate that conservation of the salmon will be endangered by additional fishing. On several occasions in the past few years, fisheries groups have taken the Department to court or occupied departmental offices to protest its decisions. As a result of these influences, a considerable amount of effort is required by fisheries managers to obtain consensus with fishing groups and to keep the various fishing interests informed. This has sometimes made it difficult for fisheries managers to give sufficient time and energy to the main objective of the Department - the protection and conservation of fish.

10.56 In our field visits to the various fisheries, we noted the dedication and commitment of fishery officers to the proper management of the fisheries and the extensive efforts that they made to consult with and keep representatives of fishing groups informed of their decisions with respect to the fishery. These officers perform a difficult and complex job in the midst of many conflicts and pressures.

Scientific Information

10.57 The fundamental piece of information needed to manage the salmon fisheries is escapement - both the number of fish escaping to a particular stream for spawning purposes and the total number that the spawning habitat can support. Biologists and other scientists assist in collecting and analysing this information. Using escapement as a base, fishery officers estimate the total run and then project what surplus will be available for fishermen.

10.58 The timeliness and accuracy of all information has become increasingly important as the efficiency and catch capacity of the fishing fleet has increased over the last few decades. In addition, under the Canada-U.S. salmon treaty, the Department has had to improve the quality of information about salmon to meet specific catch limitations set out by the treaty.

10.59 Based on our review of the management of 10 representative salmon stocks, we found that the Department has not managed its fisheries information system so as to keep pace with these required improvements. A prime example is information related to escapement.

10.60 We reviewed whether the Region had established appropriate management and information systems to ensure that it was able to achieve its target escapement levels. We found that, despite the importance of this information to the objectives of the Region and to fishery officers, the Region's management and information systems did not assist in meeting this objective. Escapement targets were often not based on sound scientific information and theory. Work plans did not include target escapement levels. The performance appraisals for fisheries managers did not emphasize the achievement of escapement targets. Also, the Region did not regularly record, monitor or assess the quality of information available on escapement.

10.61 The lack of accurate and timely information reduces the ability of fisheries managers to protect the resource. This has contributed to an estimated 1.5 per cent yearly decline in natural salmon stocks. In the case of coho and chinook salmon stocks, it is generally believed that stocks have declined significantly in recent years through overfishing. However, there isn't enough specific escapement and catch information to verify this or to identify means of redressing this problem. These information problems also reduce the Department's credibility with the fishing community and thereby affect the ability of fishery officers to justify their management actions.

10.62 The Pacific Region should develop and implement plans to improve information required for managing fish stocks on the basis of clearly defined management and research needs. It should set up quality control procedures to ensure that at least the minimum information required is collected and recorded reliably.

Exhibit 10.5

OPENING AND CLOSING A TYPICAL SALMON FISHERY

Fishery Opens - Sunday 6 p.m.

- The local fishery officer broadcasts the start of the fishing period over the radio to the fishing fleet.
- A fishery officer flies over the fishing grounds to complete a gear count or assessment of the number and types of fishing boats on the fishing grounds.
- The fishery officers, stationed in patrol boats, gather information from fishermen on the number and type of catch. During this time, fishery officers also patrol the fishery to prevent illegal fishing practices. Fishery officers are in constant radio communiction with each other.
- As the day progresses, the catch information from the fishery is recorded, totalled and communicated by radio or telephone to the District Supervisor at the district headquarters office. Progress reports are sent at regular intervals to the "communications room" in Vancouver where major fisheries are monitored.
- On the basis of information obtained from a sample of fishermen, as well as the sales slips for the fish being purchased by buyers, the fishery officers calculate the estimated catch and the strength and timing of the salmon run.
- On the basis of the estimates of the salmon run, the catch level and the amount of escapement to the spawning grounds, the District Supervisor, assisted by fishery officers and biologists, decide when to close the fishery. This can involve discussions with representatives of fishing groups and the area manager.

Fishery Closes - Monday at 6 p.m.

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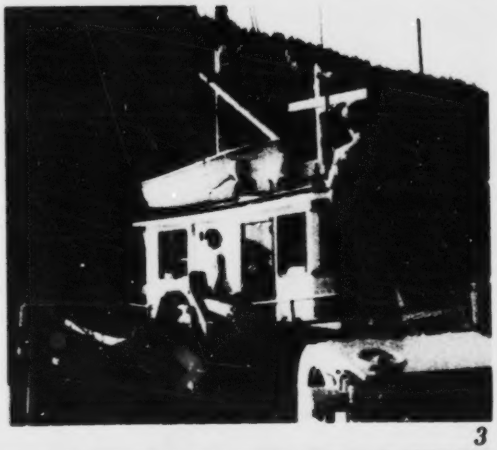

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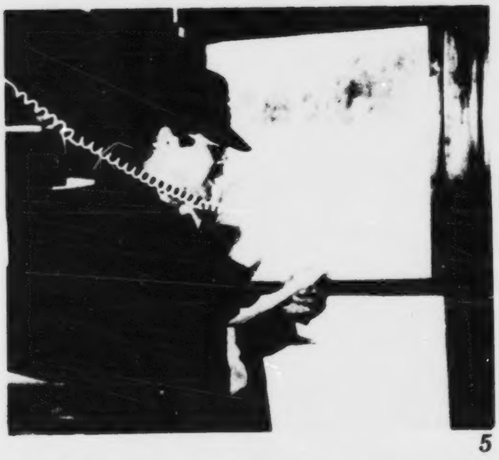


5

6

1. Fishing boats waiting their turn to set their nets. 2. & 3. Fishery officers on patrol. 4. Sales slips. 5. Calling in the day's catch totals. 6. Monitoring catch by type of equipment.

__Department's response__: Agree. Activities in this area were accelerated in 1984, when Pacific Region initiated studies to define the minimum information required to manage fish stocks. From these studies management and research needs will be defined. Complementary data management systems are being developed. Science linkages with data management and EDP are being strengthened. The Pacific Stock Assessment Review Committee (PSARC) process is being strengthened and expanded to include work on all species over the next two years. PSARC reviews projects and information to be collected to ensure quality control and design, analysis and data handling.

To define the minimum information required for managing fish will take until at least 1990/1 at current rates. This could be achieved in 1987/8 with $250,000 of contracted work. Full implementation of the minimum fisheries management program is dependent on completion of these studies, reallocation of existing resources and provision of additional resources. Based on results to date it may take incremental resources of up to 50 person-years of labour, either as term employees or contracted work, and about $4.0 million per year to implement successfully.

Economy and Efficiency of In-season Salmon Management

10.63 The Field Services Branch, which has primary responsibility for the in-season management of the Pacific fishery spends over $35 million a year on personnel, operations and equipment (including ships).

10.64 **Communication equipment.** Achieving departmental goals for resource management and enforcement requires an ability to patrol, regulate and report on events within the fishery. Radio communication is the operational system that links these field activities with resource management and enforcement decisions at the district and area levels.

10.65 The Region has spent over $2.5 million in the last five years to upgrade its communications equipment. However, we found that much of the equipment was not installed or maintained properly. As a result, the current departmental communications system does not support efficient resource management or enforcement.

10.66 For example, in the south coast area of operations, fishery officers report that a significant portion of radio communication between two key areas was garbled because of inadequate equipment. The overall impact is that officers in the field are unable to communicate reliably with other officers or with superiors. Management or enforcement decisions cannot be transmitted with any certainty.

10.67 A fishery officer may also be at personal risk because of poor communications. Officers on enforcement patrols are unable to call for assistance in potentially hazardous situations, as illustrated in the following departmental report:

> "... conducting a night patrol ... attempted to radio that they had heard the action of a pump shotgun and that they required back-up and assistance. They were unable to communicate by radio ... response was delayed and a fishery officer and an unarmed trainee apprehended two poachers without assistance. The poacher's boat contained a loaded shotgun and a loaded rifle." November 20, 1985.

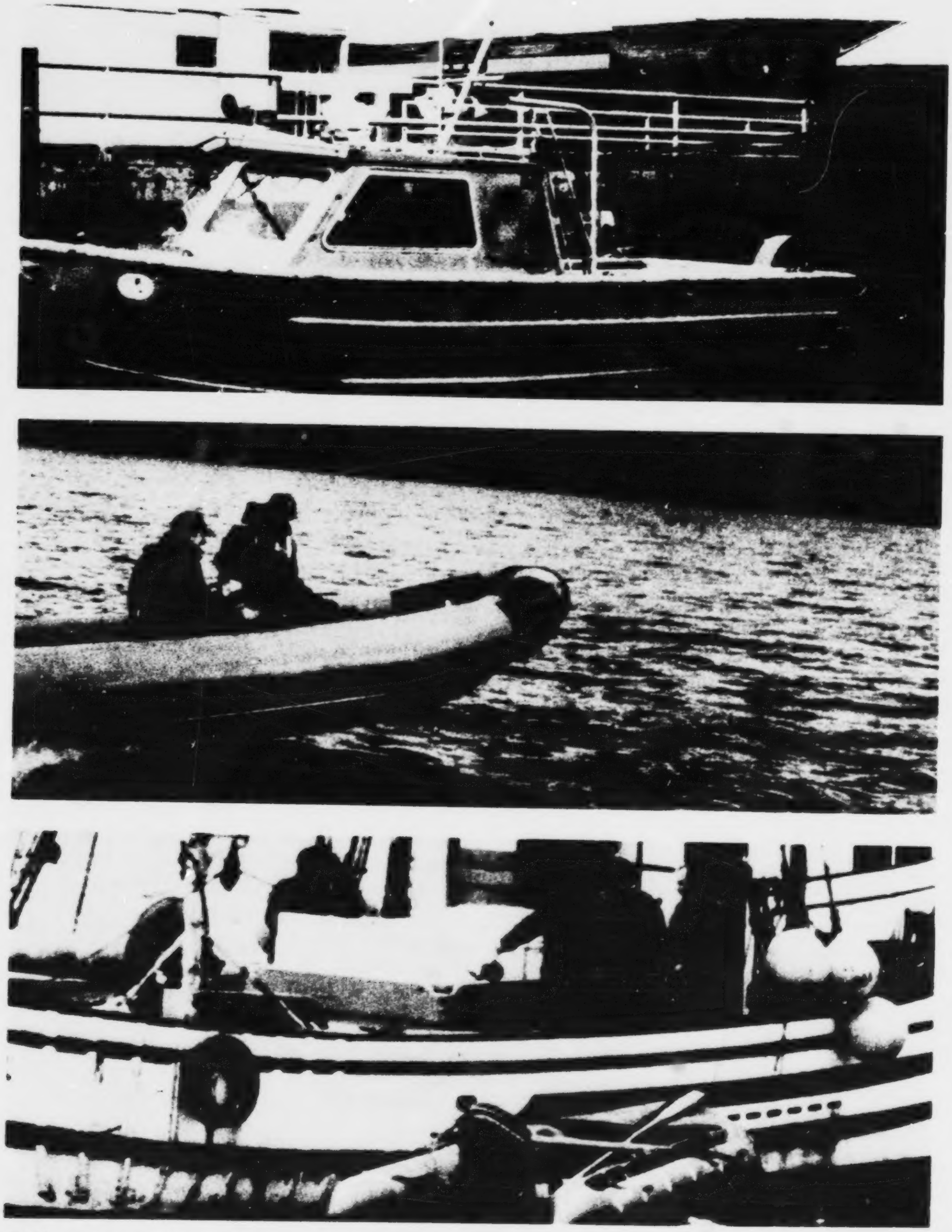
10.68 **Boats.** Small boats from 10 to 30 feet in length play a critical role in the management of the Region's fishery resources. They enable the fishery officers to monitor and regulate the fisheries. The type of boat employed, onboard equipment, maintenance practices, and officer training play a key role in determining operational capability and efficiency. We reviewed the Region's boat acquisition and maintenance practices to determine whether they satisfied fishery management requirements and were being carried out with due regard for economy and efficiency.

10.69 Over the past decade, the acquisition and equipping of small vessels in the Pacific Region have been carried out in an ad hoc, fragmented manner, without consideration for overall fleet standardization. No standards exist for vessel design and essential onboard equipment. This has resulted in an excessively diverse fleet of over 20 different types of vessels and a wide range of unique types of support equipment. For example, the Region's fleet has at least 41 different depth/fish finders models made by 12 manufacturers. This lack of standardization for boats and associated equipment has caused diseconomies and operational inefficiency. For example, it has inhibited bulk purchasing of equipment replacements and spare parts. In addition it has complicated servicing, raised costs, discouraged in-house maintenance of equipment, and increased repair turnaround time.

10.70 Boat and equipment replacements are often not preceded by re-evaluations of operational needs or analysis of alternative ways of performing the tasks. We identified a large number of vessels that were not appropriately designed or equipped to manage the fisheries to which they were assigned. For example, some patrol vessels lacked radar or radio equipment, both of which are important in identifying, apprehending and prosecuting fish violators. Others lacked an overnight capability, thus severely restricting the scope of surveillance work that can be performed.

10.71 The Region has not adequately assessed its total requirements for boats and engines in relation to its operational needs. For example, it is not clear why the Region requires 900 engines for its 600 boats or why the Field Services Branch has over 300 boats for just over 200 operational staff.

10.72 Current boat maintenance practices do not ensure that vessels are available when required, that they are being maintained at least cost, or that they are replaced when it is most economical to do so. Due to lack of preventive maintenance, the unavailability of spare parts, and insufficient technical support, boat equipment has had long periods of down-time during peak periods. Furthermore, boats and equipment are being maintained well after they should have been replaced. On the basis of manufacturer's standards, over 25 per cent of the 600 vessel fleet and 45 per cent of the Region's engines are beyond their



Different types of vessels used by Fisheries to patrol coastal waters (see paragraph 10.69).

economic lives. For example, one 17-year-old boat deployed from Port Alberni has incurred over $12,000 in maintenance costs during the last three years. By conducting equipment performance evaluations and replacement assessments the Region could reduce operating costs and improve its efficiency.

10.73 Our audit also showed that staff are not receiving adequate training and certification in vessel operation and maintenance. This has resulted in accidents and often an inability to effectively regulate the fishery. The accidents cause premature loss of equipment and exacerbate maintenance and replacement problems that already exist. Uncertified officers can also be less successful in legal cases against fishing violators.

10.74 **The Region should assess its operational needs and alternative equipment required to fulfil them. Once these needs have been assessed and the appropriate types of equipment identified, the Region should:**

- **apply life-cycle costing principles when purchasing equipment;**
- **standardize boat and equipment purchases;**
- **maintain assets and equipment according to reasonable service standards;**
- **replace assets and equipment when it is cost beneficial to do so; and**
- **ensure that personnel are adequately trained in vessel operations.**

Department's response: Agree. In progress. Ideally the recommended approach would be followed, but because of low capital allocations it is frequently not possible to replace equipment but it is possible to repair it. The current initiatives to tie capital allocations to an equipment life cycle should resolve this problem but will require a significant increase in capital budget.

A five-year Capital Plan is being developed in Pacific Region to guide capital acquisitions. The headquarters Capital Assets organization should assist.

There is agreement with more standardization of boat and equipment purchases but, because of tendering requirements, changes in product specifications and different requirements for different areas, there will be only a reduced number of models of each type of equipment, not a single standardized model.

Maintenance of assets and equipment to a reasonable service standard will require some significant changes in operations. For example, more electronics work will have to be done in-house, at an estimated incremental annual cost of 4 person-years and $200,000, to supervise contracts, handle equipment and conduct system maintenance and installations. All unpluggable electronics will be serviced on contract. Maintenance of other equipment will require approximately 4 person-years and $250,000 per year plus a two-year catch-up cost of $500,000.

Where both cost beneficial and possible, assets and equipment will be replaced as appropriate.

Starting in 1983 and each succeeding year, Pacific Region has provided basic training in small boat operations to those field staff who are regularly called on to operate vessels. This course is not a mandatory prerequisite to small boat operations. Crews of larger vessels must have appropriate certificates received from training institutes. In addition DFO does supplement this with specific training for crews.

10.75 **Data collection and analysis.** While a fishery is in progress, officers visit different portions of the fishing fleet at least twice a day to request information on the size and composition of their catch. This information is then tabulated by hand. Information is also obtained by visits to fish processors and buyers to obtain sales slips that record each purchase of fish from fishermen. Fishery officers will typically collect hundreds of these slips and analyse them manually.

10.76 The fisheries we reviewed did not have consistent sampling plans to achieve the desired level of accuracy of the catch information. There were insufficient attempts to explore ways of reducing processing time by using alternative means of data collection. Electronic data processing equipment or other technical means of reducing this labour-intensive task were not being considered.

10.77 The management of salmon fisheries also requires analysing information quickly and accurately. In recent years, biologists have increasingly been using computers to store and analyse data. In addition, a few fisheries are managed with the assistance of a computerized model. However, we found that in most fisheries, computers were not being used to assist fisheries officers to record and analyse voluminous data. The advantages of the use of such electronic tools are that information could be collected and analysed faster, more accurately and more efficiently.

10.78 **The Pacific Region should examine ways of reducing the cost of its operations and improving the quality of its information through more efficient collection, storage and processing of in-season information.**

> *Department's response: Agree. Under way. The Region is working intensively to provide adequate data management and computing capability to all regional and district offices. As a part of developing an integrated computing and data base system, Pacific Fisheries is in the second year of pilot testing an in-season catch statistics system. Hailed catch and fleet information are entered into a data base where they can be accessed by managers for in-season decision making. A pilot test transmission of Records of Management Strategies from the field to headquarters is being conducted this year. It will get fishery management considerations, data and explanations to headquarters in time for use in decision making. By fall, any DFO office will be able to access most major fisheries data bases including catch, escapement, violations and Mark Recovery Program. When these and other systems are proven, $150,000 in capital will be required to*

implement the systems and $250,000 for further development to realize fully the information benefits and cost savings.

Planning the In-season Fishery

10.79 Managing the in-season fisheries requires the co-ordination of people, information and equipment to respond to the timing and strength of the salmon run. To manage economically and efficiently in such an environment, the planning system has to specify the range of the expected number, type and capacity of fishing boats, the number and timing of the salmons migration as well as the most efficient allocation of resources, both equipment and personnel. It should also take into account the many other duties and responsibilities of a fishery officer, such as habitat protection tasks and meetings with the various user groups.

10.80 We found that the regional planning system did not allocate resources in the most economical and efficient manner. In particular, the work planning system had the following weaknesses:

- Planning was not based on intended impact or results. The Region did not set targets in terms of the objective of protecting and conserving the resource, and it did not measure the managers' achievements in those terms. Targets were stated in terms of activity levels, such as the number of fisheries managed or the number of meetings attended, rather than results such as escapement targets or reduction in poaching.
- Local managers were given little guidance on the Region's objectives and operational priorities.
- The Region's work plan did not co-ordinate the activities of different groups such as the Salmonid Enhancement Program, Habitat Branch, and Field Services Branch to ensure that these interdependent activities were consistent with meeting the Region's objectives.

10.81 With an ineffective planning system, resources were being determined on the basis of existing levels rather than on what was needed, and therefore the Region could not be sure that the resources were allocated to those areas that need them most.

10.82 **In-season planning initiatives.** The absence of a comprehensive and rigorous planning system has been of concern in the Region. Field Services Branch, with the assistance of the Planning Branch, has recently completed a pilot project where all steps in managing a fishery were examined in detail. The first job was to set out the exact nature of the fishery resource to be managed, the expected range of size and timing of the fishery, and the number and types of boats expected. This information was used to specify the nature and type of resources required to manage the fishery. These resources included expertise from the Research Branch, Field Services Branch, the Salmonid Enhancement Program and Habitat Branch as well as the necessary technical support such as ships, boats and communication equipment. If the basic elements of this planning approach were applied region-wide, it would establish a good foundation for determining resource requirements in relation to program needs.

10.83 The Pacific Region should establish, region-wide, a planning approach for determining the resource requirements of each particular fishery. In particular, it should:

- **clearly define objectives and priorities for stock management;**
- **outline how research, enhancement, habitat and other activities contribute to these priorities;**
- **identify, on the basis of workplans, the resources required to achieve the major results expected;**
- **allocate resources according to priorities and results expected; and**
- **regularly monitor and evaluate the degree to which activities achieve stated objectives.**

Department's response: Agree. Initiated in 1984. Pacific Fisheries has defined general objectives and priorities for stock management by preparing a Salmon Stock Management Plan (SSMP) in 1985. The priority for 1986/7 is to conduct South Coast analyses so as to complete a more detailed coastwide SSMP. These plans detail management targets and priorities and outline how fisheries and habitat management, enhancement, research and other activities interact to contribute to goal achievement.

Groundfish, shellfish and herring, which are dealt with in another format, are reviewed and updated every two years.

Starting in 1986/7 research, enhancement, habitat and other activities have been related to specific resource management objectives and priorities. As the work planning process changes (see recommendation 10.125) work plans will relate proposed activities and their costs to the likely results and benefits. As a part of work plan follow-up, activities will be monitored, evaluated and reported on as to their degree of goal attainment.

Herring Management

10.84 Herring are not managed the same way as salmon. This is largely because of the biological differences between the species as well as several differences in the Region's approach to managing the fishery.

10.85 The major value produced by the herring catch is the roe or eggs which supply the lucrative Japanese herring roe market. Herring school in large numbers close to the shore for a few weeks every year. At this time they are easy to catch. The Department's role in this fishery is critical. It must decide, usually within hours, when the fish should be caught. This is based on scientific assessments of when the roe level in the female herring is at its maximum. Hundreds of fishing boats participate in the annual herring fishery and the quota is reached within hours. For example, in one fishery, which lasted only 45 minutes, 850 tons of herring were caught and the value of the catch was about $2 million. The Department sets a maximum quota of herring to be caught, and fishery officers stop the fishing when the quota has been reached.

10.86 In the late sixties, the herring stocks in British Columbia collapsed from overfishing coupled with biological factors. In subsequent years, much was done to improve the management of those stocks. It was decided to manage the annual herring fisheries centrally and to improve the quality of scientific information, planning and enforcement. Accordingly, a Herring Co-ordinator was appointed, and management and scientific committees were formed. In 1981, an area licensing scheme was also introduced to strengthen further the management of herring stocks.

10.87 As a result of these management initiatives, the herring fishery, although more hectic than the average salmon fishery, can be better controlled. According to the Department there has been some reduction of fleet capacity, the necessary scientific information is more readily available and there have been annual reviews of management decisions.

Salmonid Enhancement Program

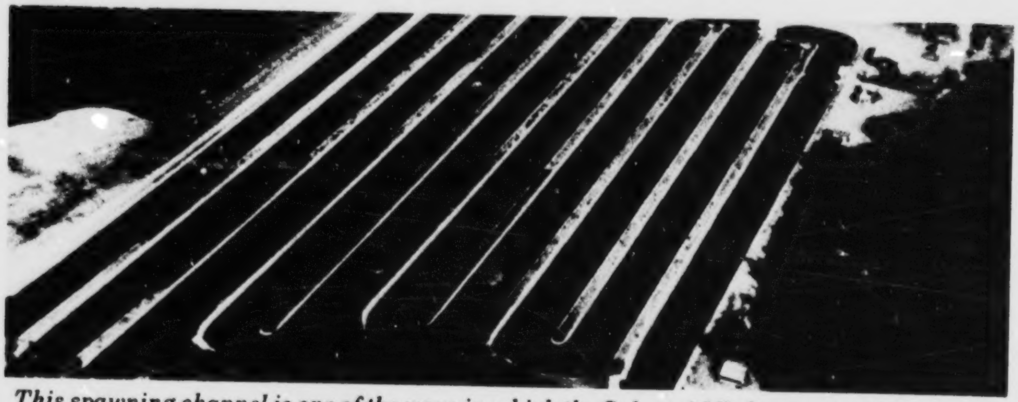
Background

10.88 One of the cornerstones of Pacific fisheries programs over the last 10 years has been the Salmonid Enhancement Program (SEP). A joint federal/provincial program originally conceived and approved in the mid-1970s, it was designed to double the number of salmon caught by the late 1990s, thereby providing significant economic and social benefits to commercial, recreational and Indian groups. The program uses a range of enhancement techniques such as hatcheries, fishways and spawning channels, and takes steps to enrich lakes and improve fish habitat.

10.89 The total construction and operating costs over the first nine years of the program were over $250 million. In Phase II of SEP, the Department proposes to spend approximately $200 million between now and 1991. This is in addition to ongoing funding of approximately $20 million a year.

10.90 SEP developed a sophisticated procedure for assessing potential benefits and costs. This "five account system" was to display all benefits and costs, both social and economic, for each proposed project. This planning tool represented a major accomplishment in public sector management where social and economic goals are mixed.

10.91 Using this approach, the cost-benefit ratio of the program was to be 1.5:1 (this means that $1.50 in fish values were to be generated for each $1.00 expended). To achieve the expected cost-benefit ratio, one premise of the program was that the fleet capacity would not expand in anticipation of the increased availability of fish.



This spawning channel is one of the ways in which the Salmonid Enhancement Program is increasing salmon quantities (see paragraph 10.92).

Program Accomplishments

10.92 Since its inception, SEP has reported some major successes:

- A large number of fish have been released from enhancement facilities to streams, and this has contributed to the commercial, recreational and Indian catch.

- Some parts of the program appear to have been particularly effective in producing increased numbers of fish at low cost. These include stream habitat improvements as well as the lake enrichment program. Lake enrichment appears to have produced about one-quarter of all SEP fish at a cost of about five per cent of the budget.

- SEP management has supported biological research and has learned from the experience of running the various aspects of the program such as bio-engineering, hatchery management, sampling and counting fish. It has contributed to managing the natural stock by funding the Salmon Management Plan and facilitating the negotiations of the Canada-U.S. treaty.

- SEP has provided employment that otherwise might not have been available to Indians and remote communities.

Current Questions About the Costs and Benefits of SEP

10.93 Because of the experimental nature of enhancement as well as the natural uncertainties associated with the salmon resource, the program continues to be faced with a number of concerns. Some of these are as follows:

- Fish from some facilities may be displacing wild stocks of salmon, rather than adding to them.

- Harvesting of enhanced fish may be adversely reducing the genetic diversity of the salmon stocks and thereby increasing certain risks to the salmon population.

- SEP has aggravated or created mixed stock harvesting problems. To protect the wild stocks mixed in with the enhanced stocks, fishery managers have limited the harvest of enhanced stocks to lower levels than would otherwise be possible.

- Because some of the benefits of the program will be dissipated through unnecessary or uneconomic investment in fleet expansion, the Region estimates that program benefits could be reduced by 15 per cent.

- There is some evidence that the productivity of hatcheries for some species of salmon (chinook and coho) may decline in the long term, for reasons still not clearly understood.

- As actual fish-returns data become available, some hatcheries may be shown to have higher costs than benefits. Using the Department's documents, it is not clear whether the costs of major facilities will be greater than benefits before the year 2000, assuming no new capital investment and no increase in fleet capacity.

10.94 Given these types of concerns, we would have expected managers to have in place measures of program costs and actual benefits and to have used them in program management. We found that the Region is only now beginning to assess the costs and benefits of the program rather than relying on projections.

10.95 SEP data are incomplete partly because it takes several generations of returning salmon before the benefit of this investment can be assessed and partly because of a failure in managing data. The Region has not moved quickly enough to collect and analyse information on actual fish returns. This information is needed by program managers to review the cost-effectiveness of the various enhancement activities in SEP as well as to provide a basis for SEP II proposals.

10.96 The Region should assess and report the actual benefits and costs of key components of the Salmonid Enhancement Program. This should include the costs and benefits of each hatchery.

> *Department's response: Agree with basic intent. As most new enhancement projects constructed during SEP Phase I are just beginning to show results in the fishery, it is not yet appropriate to use actual benefits to make decisions on individual projects, and therefore projections must continue to be used for several years. A comprehensive biological-economic evaluation of SEP production data was completed in 1986. This level of evaluation was made possible by bringing a Mark Recovery Data base into operation. This data base facilitates detailed analysis of catch of fish produced in enhancement facilities, particularly chinook and coho.*

> *All projects, not just hatcheries, will be included in an evaluation framework for SEP which will report on estimated actual benefits and costs versus projections for each project. The format of the framework will also include key components and interdependent project groupings and is planned to be completed for review by the SEP Board in the current fiscal year. Project data would then be entered into the new framework over the following years as restrained by available person-years and EDP services.*

Cost Recovery

10.97 The original SEP proposals and subsequent departmental documents proposed that the full program costs would be recovered. Cost recovery was justified first on the basis that the government was investing in a resource that provided benefits to specific segments of the population and second by the fact that similar overall levels of salmon stock rebuilding could have been achieved without direct government investment but by cutting back on the amount of fishing. According to departmental proposals on cost recovery:

- In 1977, the government approved funding for the Salmonid Enhancement Program, conditional on the implementation of cost-recovery by 1 January 1979.
- In the Speech from the Throne of 14 April 1980, the government pledged the introduction of cost-recovery measures as a step toward enhanced economic development of the fishing industry.
- The federal-provincial agreement with the Province of British Columbia provided that the two governments could recover their direct costs of projects in the SEP.
- In 1981, saltwater sportfishing licences were implemented and commercial licence fees were increased, in part as a SEP cost-recovery mechanism.
- The approval for the transition phase of SEP directed that the Department present a paper to Cabinet by 1 December 1983 outlining the Department's policy regarding cost recovery of SEP.

10.98 To date, less than 10 per cent of the $250 million program costs has been recovered.

10.99 Finally, SEP is not integrated with a fleet management plan that would prevent wasteful re-investment in needless fishing capacity. As the Department noted in a recent program review:

> It is well known that the salmon fleet is highly over-capitalized. Poor earnings (due to excessive costs, not insufficient catch or revenues) and a high debt load, fishermen argue, make their contribution to funding for SEP continuation difficult if not impossible.

> As long as re-investment of profits is not controlled, any attempt to improve the economics of the salmon fishery cannot be sustainable. Whether increased profits come from windfall catches of wild stocks, buoyant prices, or a successful enhancement program, the result will be the same: profits will be re-invested to increase fleet capacity in the needless 'race for the fish'. The dissipation of benefits from a program such as SEP is significant.

The Department is now entering the second phase of the program and is proposing various cost-recovery options, including a larger contribution from the various user groups.

Managing Regional Resources

10.100 This part of the audit focused on how the Region was managing its overall budget and human resources in the context of its program challenges and requirements. We looked at whether the Region was managing its resources efficiently and economically, and whether administrative support functions were providing the necessary assistance to the main operational activities of the Department. We reviewed the process of planning and budgeting as well as four major expenditure areas of the Region – contracting, inventory and materiel management, computers, and overtime.

Planning and Budgeting

10.101 We reviewed the operational and work planning process that was carried out in preparation for the 1986-87 fiscal year. To manage in its complex environment and to cope with many competing demands, we expected that the Region would have a management process that would clearly define priorities and assess resource requirements.

10.102 The Region is currently faced with some budgetary pressures as a result of the federal government's restraint program. At the same time, it is facing requirements for expenditures in areas such as EDP, aquaculture, co-management with Indian bands, and equipment. Consequently, we expected that the Region would have methods to relate resource requirements to program outputs or expected results, review work plans with a view to increasing economy and efficiency, and identify areas where savings would be made or where resources could be re-directed to higher priority functions.

10.103 We found that the Region did not have an adequate planning and budgeting process. For example:

- The Region did not have clear priorities and strategies to guide its overall activities.
- The Region did not systematically analyse expenditures in relation to the achievement of regional goals or objectives. It did not develop an overall operational plan to define priorities and outline how the various interdependent functions of the organization would contribute to achieving goals and recognize priorities.

- There was little relationship between the resources requested and the outputs or results expected of the Region. For example, work plans did not include a major indicator of performance in the salmon fishery - the level of escapement achieved for various stocks.

10.104 Without an adequate planning and budgeting system that reflects the essential tasks of the organization, the Region cannot be sure that it is achieving the Department's mandate at a reasonable cost.

Contracting

10.105 Contracting for goods and services represents an expenditure of $25 million a year, or about 20 per cent of the total resources of the Region. In assessing whether contracting in the Pacific Region was being managed with due regard for economy, we examined 20 contracts with a value of $4.3 million.

10.106 We found that contracting was not being managed in accordance with government guidelines. There were numerous examples of poor contracting practices such as work started before contracts were signed and inadequate justification of sole-source contracts. In response to senior management concerns about the contracting process, the Region has recently strengthened the role of its contract review board.

10.107 We also reviewed a sample of contracts to operate SEP hatcheries. Under present contracting guidelines provided by Treasury Board, contracts should not be used when there are employer-employee relationships involved. In the case of hatchery contracts, it is very difficult to distinguish between the work done by contractors and work that would normally be done by employees. It is also not clear whether contracting for hatcheries work is more cost-effective than other alternatives such as using term employees.

10.108 **The Region and the Department should re-assess the approach of using contractors for hatchery work from the point of view of cost-effectiveness and compliance with existing government contracting guidelines.**

> *Department's response: Agree in principle. The current contracting-out approach has evolved over time as the most practical and cost-effective within the constraints of available person-years. In order to do this, the Department must reallocate or obtain new person-years for hatchery operations or SEP will be forced to continue with the most practical and cost-effective contracting procedures that comply with existing government contracting guidelines. If person-years were available for hatchery work, then re-assessing contracting out would be of benefit. All contracts are routinely examined by both DFO and DSS for compliance to guidelines.*

Inventory and Materiel Management

10.109 The Pacific Region spent about $5 million or 5 per cent of its total budget for 1985-86 on capital and equipment. This included ships, small boats, communications equipment and cars.

10.110 We reviewed the overall inventory management system for all materiel in the Region and did an in-depth analysis of the management of the Region's 600 small boats and support equipment.

10.111 The Region did not have an adequate record of its assets. Without this information, it is not able to analyse its equipment acquisition and maintenance requirements or to be assured that requests for new equipment could not be met by surpluses from other areas. In addition, the Region is not able to determine when equipment, such as small boats, should be replaced because maintenance costs have become too high. The management problems with respect to boats and communications equipment that have resulted from these poor materiel management practices were discussed earlier starting at paragraph 10.63.

Computers (EDP)

10.112 To conduct the necessary research and enforcement activities and to monitor the fisheries, the Region requires timely, accurate, easily accessible information in areas such as the total catch by various species or the extent of escapement by particular stream or area. Computers have, therefore, become essential to departmental operations and could be used to increase the efficiency of processing information.

10.113 The Region has been slow to adapt EDP technology to collecting and analysing information for the fisheries. There has been a considerable amount of confusion about how best to use computer technology to carry out the Region's functions. In 1982 the Pearse Report recommended the development of a regional data system for fisheries management. At the time of our audit, this system was still being developed. Regional management has had considerable difficulty agreeing on an overall strategy for the use of EDP in the Region that would meet the needs of the diverse users (scientific groups, administration, fishery officers). Meanwhile, area and district managers are not well supported with computers to help them do their work.

10.114 The computer system currently being used for licensing records is uneconomical. The computer requirements for licensing, which are contracted with a service bureau, cost $351,000 to operate in 1985-86. If the Region were to use alternative technology for licensing records (microcomputers, for example), it could save between $100,000 and $200,000 a year in operating costs.

10.115 The major EDP priority or challenge for the Region over the next two years is to determine how to use advanced computer technology to support its fisheries management and stock information functions.

Overtime

10.116 The nature of the work in the Pacific Region requires many employees to work considerable overtime during peak periods of the year. Overtime work often involves monitoring or enforcement activity during the salmon or herring fishery, or hatchery work during spawning periods. As a result, overtime is recognized as an important resource and as a necessary feature of fisheries work.

10.117 Overtime costs for 1984-85 were $3.6 million, excluding compensatory time. In view of the significance of the amount of money involved, we examined whether the Region had adequate information and analysis on the use of overtime and whether it was an economical use of human resources.

10.118 We found that although the Region has instituted some broad controls on the use of overtime, it does not adequately manage overtime to ensure that costs are minimized. It does not maintain sufficient information on the amount and reasons for overtime or assess alternatives, such as hiring temporary staff, for using staff more economically.

Licensing: Cost Recovery

10.119 Licensing boats and fishermen represented about $4.6 million in revenues for the Pacific Region in the 1985-86 fiscal year.

10.120 We reviewed whether the Region was implementing Treasury Board guidelines on cost recovery with respect to licensing. These guidelines require departments to review their rates on a regular basis. We found that the rate structures for various licences were not reviewed regularly. For example, the rate structure for salmon licences was last reviewed and revised in 1980, and herring roe licences were reviewed in 1974. The recreational fishing licence fees were reviewed in 1983, but they remain at $5 a year. We also found that there was no consistent or clear rationale for the rate structure for licences that related to the objectives of the Department, the value of the fisheries, or the costs of managing the fisheries.

10.121 The Minister has recently announced that he wants to raise recreational fishing licence fees to increase the level of cost recovery for the Salmonid Enhancement Program. The Department needs to review how licence fees or other forms of cost recovery could help to improve the overall management of the fishery as well as to increase government revenue.

Conclusions and Recommendation

10.122 Under its present planning and budgeting system, the Region is not managing its regional resources to ensure that program requirements are being achieved at reasonable costs.

10.123 The underlying reason for the weaknesses in all these areas is that improving the management of resources has not been viewed as a high priority. The major preoccupation of the Region has been responding to the day-to-day pressures involved in managing the fisheries. There has been little emphasis on managing its total resources to achieve agreed upon objectives or results.

10.124 The main challenge is to develop an overall operational planning system for the Region that is co-ordinated with the more rigorous planning approach for each fishery, as discussed in paragraph 10.79. This would provide a focus for management improvement and a basis for the Region to manage its resources more economically and efficiently.

10.125 The Region should improve the operational planning process. This process should be specifically tailored to the Region's program management requirements. It should be a key tool for managing the resources of the Region and for co-ordinating the work of the various divisions or functions. The major output of this process should be an annual operational plan that:

- **clearly defines major priorities for the Region and for the fishery;**
- **outlines how the various activities directly affecting fisheries management will contribute to these priorities;**
- **identifies areas for reduction of or changes in resource levels;**
- **defines how key resource areas such as contracting, overtime, computers and materiel can contribute to achieving the objectives of the Region in the most economical and efficient manner; and**
- **outlines the resources required to achieve the major outputs or results expected by the whole Region and by each of its major functions.**

Department's response: Agree. Since 1984, the Region has conducted a number of pilot activities which will ultimately lead to satisfying this recommendation. Work is under way on developing a basic operational framework that will relate basic fisheries and habitat management and enhancement activities to the fisheries resource, on a watershed basis, and define a minimum required program and priorities. It will make achieving explicit fish escapement targets a part of performance measurement and managerial accountability. Work is also under way on quantification of habitat capacity to relate current and potential fish production capacity to proposed management activities. These changes will allow preparation of work plans that relate fisheries management activities to priorities, benefits to costs and risks and program trade-offs to likely impacts. Area Planning Committees have been formed to co-ordinate DFO branch plans and activities in each area. These committees also involve the B.C. Provincial Fisheries Branch.

Quantification of the fisheries resource management activities will permit defining how contracting, overtime, computers and material contribute to goal achievement. Quantification will also help to justify and explain program resources required to achieve the outputs and results that the Region is charged with delivering.

Pilot projects on quantification have been expanded in 1986. It is projected that Region-wide coverage will be completed in 1989/90. Operational planning will continue to change in response to these pilot activities but will be fully implemented to the level recommended in 1990/1. For $200,000, these pilot developments could be completed in 1987/8 and operational planning for 1988/9 could be in the recommended format.

The harbour in Comox, B.C. is one of the 800 recreational harbours in the Pacific and Inland Regions (see paragraph 10.130).

The Inland Region

Background

10.126 The Inland Region includes Ontario, the Prairie provinces, the Northwest Territories and the Yukon. Its responsibility is to administer the Fisheries Act with respect to freshwater fisheries and small craft harbours, both recreational and commercial.

Management of Freshwater Fisheries

10.127 Although the Department has delegated administrative responsibility for freshwater fisheries to Ontario and the Prairie provinces, the legislative responsibilities for preserving and conserving fish remain with the federal government. There has been no delegation of fisheries responsibility to the two territorial governments.

10.128 There is considerable confusion between the Department and the provincial governments with respect to their roles in habitat and fish management. For example, enforcement of the freshwater habitat provisions of the Fisheries Act is inconsistent. Department officials are not clear who should bring charges under the Act. Further, it is not clear who is responsible for the current state of the freshwater fisheries. The provinces license fishermen and determine how many fish can be caught, but the federal government has legislative responsibility for the resource.

10.129 The Department has recognized the need to clarify the way it will exercise its responsibility for freshwater fish. It is currently attempting to clarify fisheries habitat and management responsibilities through general fisheries agreements with the provinces. The Department has entered into such an agreement with British Columbia, is in the process of negotiating one with Ontario, and hopes to negotiate similar agreements with the Prairie provinces.

Recreational Harbours

10.130 One of the unique features of the Pacific and Inland Regions is the high proportion of recreational harbours. Over eighty per cent of the Department's total asset value (about $450 million) of recreational harbours is located in these Regions. We audited the management of recreational harbours in this phase of the audit; commercial harbours will be covered in a subsequent audit.

10.131 The Department has had considerable difficulty maintaining its 800 recreational harbours with its limited budget of $5 million. For example, in Ontario, the Department estimates that 67 per cent of approximately 400 harbours are in fair or poor condition, and that it would cost $148 million to bring all recreational harbours to good condition.

10.132 Despite the limited funds available to maintain recreational harbours, the Department has not adequately reviewed its harbour fees in relation to its costs or in comparison to private marina rates. The fees charged at small craft harbours have been increased only once in the last eight years. That change, in 1984, increased berthage charges by only five per cent. Comparable fees at privately operated and agency operated (leased) harbours are up to three times higher than government rates.

10.133 The Department has recently submitted proposed rate increases to make its rate equivalent to private harbours. At the time of the audit, the fees had not been adjusted. These rate changes would contribute an additional $1 million annual revenue to the government.

DEPARTMENT OF INDIAN AFFAIRS AND NORTHERN DEVELOPMENT

DEPARTMENT OF INDIAN AFFAIRS AND NORTHERN DEVELOPMENT

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11

DEPARTMENT OF INDIAN AFFAIRS AND NORTHERN DEVELOPMENT

Introduction

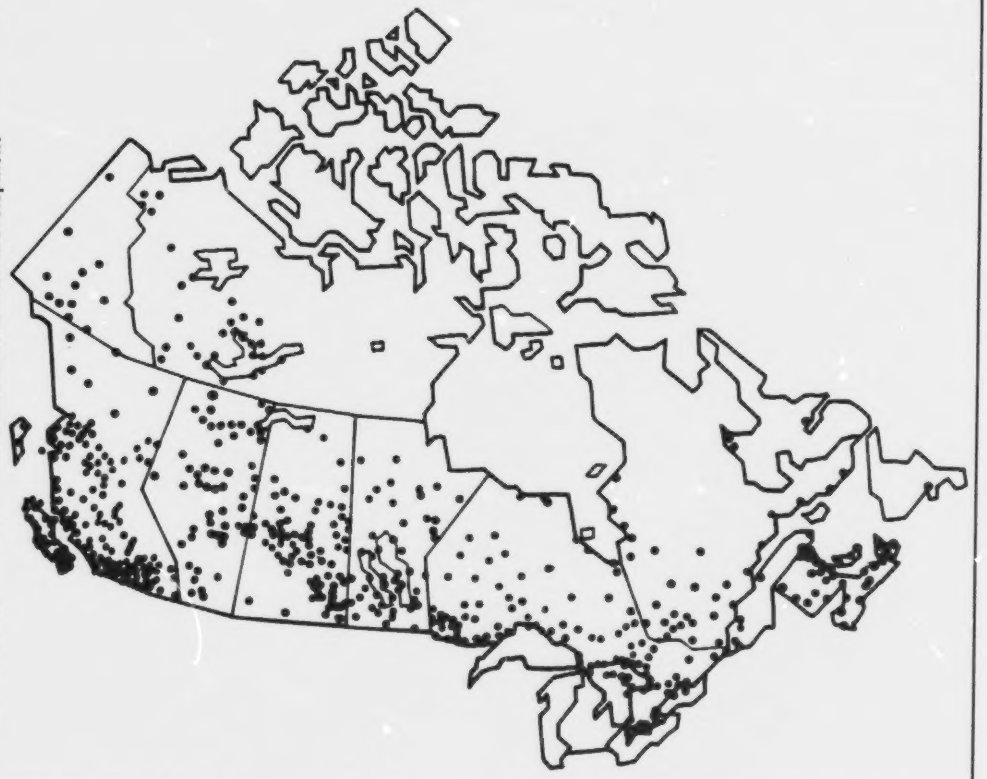
11.1 The Department of Indian Affairs and Northern Development Act, 1970, defines the responsibilities of the Department. The Department administers this and 40 other Acts of Parliament. According to its statement of responsibilities in Part III of the 1985-86 Estimates, the Department:

- fulfils the lawful obligations of the federal government arising from treaties and the Indian Act (for example, paying treaty benefits and administering Indian lands and trust moneys);
- provides for the delivery of basic services (such as education, social assistance, housing and development of community infrastructure) to status Indian and Inuit communities;
- assists Indians and Inuit to acquire employment skills and to develop viable businesses;
- negotiates the settlement of accepted claims relating to aboriginal title not extinguished by treaty or other means, or relating to past non-fulfilment of government obligations;
- makes transfer payments to the governments of the Yukon and the Northwest Territories to assist them in providing public services to territorial residents in accordance with the Yukon and Northwest Territories Acts and other agreements;
- provides for the balanced development of the North through management of natural resources (oil and gas, minerals, water, forests and lands); protection and management of the northern natural environment, including Arctic seas; fostering of economic and employment opportunities for northerners; and funding of social and cultural programs; and
- fosters political development of the two northern territories and co-ordinates federal policies and programming for the North.

11.2 In December 1984 there were 581 Indian bands across Canada and approximately 349,000 status Indians. The majority of Indian bands south of the 60th parallel are located on reserves. In the Yukon and Northwest Territories, only a small number of Indians live on reserve lands. There are 2,254 separate parcels of reserve lands in Canada, with a total area of approximately 2.6 million hectares (6.5 million acres). There were about 25,400 Inuit living in about 50 communities and settlements. Due to geographic, cultural and other considerations there is a wide diversity of goals, abilities and priorities among the Indian communities. The Department thus operates in an environment that is both complex and controversial, because of the vast range of competing demands from its different client groups. (See Exhibits 11.1 and 11.2.)

Exhibit 11.1

INDIAN BANDS



Courtesy Department of Indian Affairs and Northern Development

At the last census, Indian bands ranged in size from two members (New Westminster, British Columbia) to 10,367 members (Six Nations of the Grand River, Ontario). The average band size grew from about 350 in 1960 to about 550 in 1980.

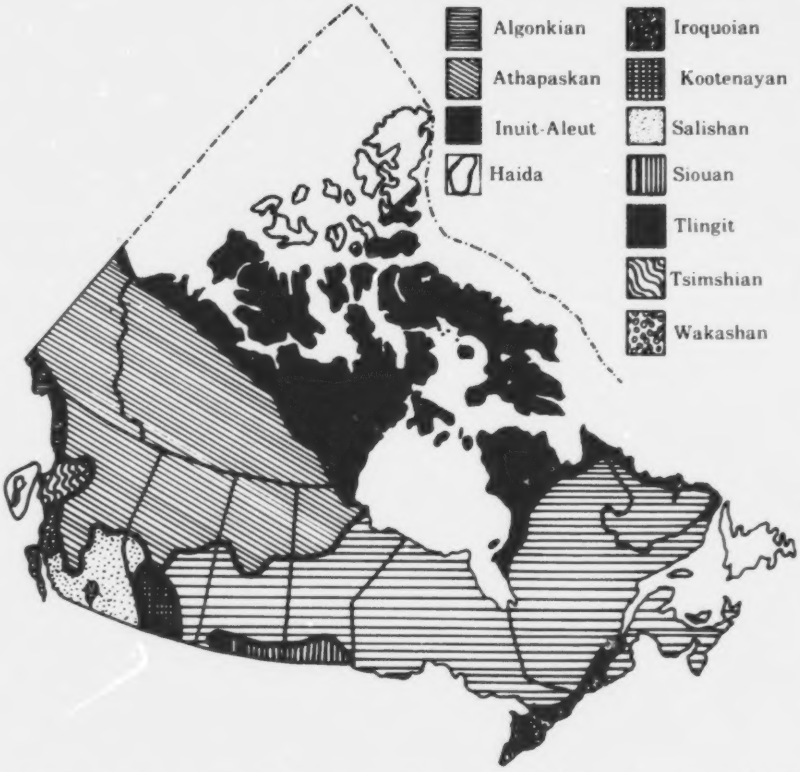
1980 Comprehensive Audit

11.3 In our first comprehensive audit of the Department of Indian Affairs and Northern Development (DIAND) in 1980, we examined the planning and control systems to support financial, personnel and program management. Our main recommendations in reporting on that audit were related to the Department's mandate and its role in managing Indian band funds and funds for Indian children.

11.4 **Mandate**. The Department's mandate was not clear; thus its relationship to Indians and Inuit was not specified clearly enough to define what DIAND should be accountable for. Specifically, the Department was not sure whether it was accountable for producing social and economic gains for native people or was responsible simply for ensuring an equitable distribution of financial support as native groups pursued their own objectives.

Exhibit 11 2

NATIVE LINGUISTIC FAMILIES
(approximate areas)



Courtesy Department of Indian Affairs and Northern Development

There are 10 Indian linguistic groups in Canada, each with a number of sub-groups speaking related languages or dialects. The Department must accommodate these differences, and cultural differences across the country, in ensuring that Indian education is "relevant to the social, economic and cultural needs of the individuals, bands and communities being served."

There is a great difference between these two orientations, and we were of the opinion that this had to be clarified before the Department could establish a structure for accountability. The measures of accountability would be quite different for the two orientations.

11.5 The Standing Committee on Public Accounts, in its Sixth Report to the House of Commons dated 23 June 1981, recommended that the Department take the necessary steps to clarify its mandate, especially in light of the absence of specific objectives, plans or goals against which its achievements could be measured.

11.6 The Department informed the Chairperson of the Standing Committee on Public Accounts in May 1985 that the Minister had commissioned a fundamental review of the Department's mandate, the processes by which it is carried out, and the relationship of the Department to the Indian people.

11.7 **Contributions to Indian bands.** In 1980 we reported to Parliament that the Department did not have assurance that contributions to Indian bands had been used for the purposes for which they were given, as required by Treasury Board. The Department responded that the control mechanisms necessary to meet Treasury Board requirements might have been beyond the current administrative capability of many bands. It has initiated negotiations with Treasury Board to develop an accountability process that is more appropriate for both the Indians and the government. At the time of writing this report, an "alternative funding arrangement" was being negotiated with Treasury Board. The objective of this arrangement is to put in place a new set of methods that would enable Indian communities to take responsibility and be accountable for funds received. In 1986-87, contributions to Indian bands will exceed $1 billion and the Department still has not established appropriate control for the contributions.

Scope of this Audit

11.8 This year's audit focused on areas that were not given detailed examination in the last comprehensive audit. We examined the Reserve and Trust activities of the Indian and Inuit Affairs Program – specifically the management of Indian lands, the administration of Indian estates and the administration of Indian band capital and revenue accounts and trust accounts for minors. We also looked at the Elementary and Secondary Education activities. Twenty-six per cent ($409 million) of the total 1986-87 budget for the Indian and Inuit Program went to provide elementary and secondary education to Indian children living on reserves or Crown lands. We also examined the Office of Native Claims and the major management systems, practices and controls of two development projects and the management of renewable resources by the Northern Affairs Program.

11.9 We placed a certain amount of reliance on the work of the Departmental Audit Branch. Reliance was, of necessity, limited by the fact that the scope of the Branch's work was not as broad as our audit scope.

Reserves and Trusts

Introduction

11.10 The Department of Indian Affairs and Northern Development Act and the Indian Act provide authority to the Department, through its Minister, to administer reserve lands, band funds and the estates of certain individual Indians, and to determine entitlement to Indian status and band membership. The Department thus has the mandate to ensure that Indian lands and estates are managed in accordance with the legislation and that all status Indians are duly registered. These activities are carried out in nine regional offices across the country and two minerals offices located in Calgary and Ottawa. Functional guidance is provided from headquarters in Ottawa.

11.11 The mandate of the Reserves and Trusts Branch, as well as the Department as a whole, is derived from the statutes the Department administers. The precise meaning of this mandate has been the subject of debate and confusion over the years. The confusion is caused by the imprecise nature of the legislation. While the Department may not be able to state its legal role unequivocally, its responsibilities for land management can be clearly stated to be the administration of lands reserved for the use and benefit of Indians and bands. In late 1984, a decision of the Supreme Court of Canada confirmed that the Department has a fiduciary duty to the Indian people with respect to surrenders of reserve land. (The Indian Act defines "surrendered lands" as a "reserve or part of a reserve or any interest therein, the legal title to which remains vested in Her Majesty, that has been released or surrendered by the band for whose use and benefit it was set apart".)

Audit Scope

11.12 We conducted a detailed examination of the way the Department interprets and carries out its role and its general ability to satisfy the responsibility attached to it. We focused on the Department's compliance with its legal mandate, in light of the recent Supreme Court decision, and on the procedures and resources in place to carry out that mandate.

11.13 We selected three areas within the Reserves and Trusts Branch for examination. These were the functions of land management, estate administration and band fund administration. First, we attempted to ascertain what the Department's legal mandate was by looking at statutes, recent case law and the Department's perception of its mandate. Second, we reviewed the Department's administrative process and compared its legal requirements and practices with those of private trust companies, which have a comparable fiduciary status. Finally, we looked at the human resources employed by the Department and made a general assessment of their appropriateness, again in light of the legal requirements and the practices laid down in law and observed by private trust companies.

Land Management

11.14 **Legal mandate**. The legal mandate of the Department of Indian Affairs and Northern Development relating to reserves and trusts is not easily defined. In the 1984 case of *Guerin et al.* v. *The Queen*, the Supreme Court of Canada considered the Department's role with respect to transactions involving surrenders of Indian lands, and held that the Crown had a fiduciary obligation to the Indian peoples of Canada. A fiduciary is a person who, having been entrusted with powers for another's benefit, is under a general obligation when using those powers to act honestly in what he or she considers to be that other's interest and to uphold certain standards of loyalty and fidelity. A trustee is an example of a person charged with a fiduciary responsibility. In the Guerin case, the court held that, in leasing land on behalf of the Musqueam band of British Columbia, officials of the Department were acting in a fiduciary capacity. By leasing the land on terms much less favourable than those approved by the band, the officials failed to act in the Indians' best interest, and therefore were in breach of their fiduciary duties.

11.15 Until this decision, the Department had viewed the obligation created by its legislation as something of a "political" trust, but not a trust for which the beneficiaries could obtain relief from a court if it failed to discharge its responsibilities. As a result of the Guerin case, the Department is now aware that it has a fiduciary responsibility, at least with respect to surrenders, and that this responsibility is enforceable in a court of law. It is also aware that it must now examine and revise its procedures and policies in a number of areas to ensure it is living up to this responsibility.

11.16 The Lands Directorate of the Reserves and Trusts Branch administers Crown lands set aside for the use and benefit of Indian bands. It also provides policy advice to regional and district offices and to bands on management of Indian reserves, surrenders of reserve land, leases of surrendered lands and leases of reserve lands to band members and others. The Lands Directorate helps bands draw up surrenders so land may be leased; without them, bands generally cannot lease land to non-band members. Bands thus rely on the Directorate's expertise in carrying out surrenders quickly and efficiently when they have prospective lessees. They also rely on the Directorate to ensure that their wishes are taken into account in all transactions.

11.17 **Inventory of lands and natural resources.** One function of the Lands Directorate is to maintain an inventory of all reserve land. Despite this requirement, at the time of our audit there was no complete and accurate national inventory of reserve land and natural resources by individual band. We believe that such an inventory, including an indication of recommended land use, is necessary if the Department is to fulfil its fiduciary responsibilities in this connection. The potential liability for lost opportunities and failure to obtain the optimum return from reserve lands could be substantial if it does not have this information. The Department recognizes that this is a problem that needs attention but as yet has been unable to find a solution.

11.18 **The Department of Indian Affairs and Northern Development should compile and maintain a complete, accurate, and up-to-date inventory of Indian lands and natural resources.**

> *Department's response: The Department sees two aspects to this question - a registry of Indian lands and an indication of economic potential.*
>
> *The Lands Directorate maintains an Indian Land Registry for the purpose of recording transactions on reserve and surrendered lands, as required by sections 21 and 55 of the Indian Act. However, the completeness and accuracy of Registry records vary greatly from one reserve to another. In many cases, jurisdiction over Indian land was transferred to the federal government - either at the time of Confederation or subsequently - with only a general description of its exact location, its size, and the restrictions or exclusions which applied. In 1978 it was estimated that 300 person-years would be required to carry out the detailed research needed to compile a complete and up-to-date land inventory. At present, due to limited resources, such research is undertaken on a case-by-case basis to deal with individual problems as they arise.*
>
> *The second aspect of the question relates to the assessment of economic potential of Indian land and natural resources. The recent re-organization of the Department included the appointment of an Assistant Deputy Minister for Economic Development, and this will allow the Department to increase its efforts in this regard. Of particular interest is the significant increase in departmental resources assigned to carry out our oil and gas responsibilities, including the development and maintenance of an inventory of oil and gas resources on Indian lands. In addition, there are plans to complete the inventories of other mineral*

resources on reserves in British Columbia and the Maritime provinces. Mineral resource inventories will subsequently be completed for the remaining provinces.

11.19 **Access to legal services.** The Lands Directorate lacks adequate access to legal specialists. The access to Department of Justice lawyers in the regions and at headquarters is seen by employees as insufficient. Justice lawyers are not always available to work on Indian matters. The result is that legal opinions on leases and surrenders cannot be obtained as quickly as necessary. Because markets and land transactions often cannot wait, opportunities are lost. This also exposes the Department to potential liability for failing to provide adequate services to the Indian people.

11.20 **In view of the potential liability for failure to provide an adequate service, the Department of Indian Affairs and Northern Development should, in conjunction with the Department of Justice, carry out an assessment of its requirements for legal services at the national and regional level and determine the most appropriate method of meeting this requirement.**

Department's response: The two departments have been cognizant of this problem, and are working to resolve the difficulties.

11.21 **Training and supervision of land management agents.** One of the duties of a fiduciary, when choosing and supervising agents to act on its behalf, is to ensure that they have the required expertise to carry out the task for which they are hired. If this is not done, the fiduciary may be liable for acts of the agent that are in breach of the fiduciary relationship.

11.22 Employees dealing with land appraisals, legal surveys, contracts and leases require highly specialized training to discharge their fiduciary responsibilities properly. They need such knowledge not only to do work assigned to them but also to be able to identify problems when they arise.

11.23 In reviewing the practices of private trust companies, we found that they take care to ensure that they have well trained people to carry out such responsibilities. In the Reserves and Trusts Branch, however, certain employees handling leases and surrenders had neither the background nor the training needed to discharge such responsibilities with the trustee's high standard of care. The majority had come up through the ranks, basically from clerical levels. Very little training has been provided by the Department.

11.24 Since the Guerin decision, there has been an attempt in the British Columbia region to hire more specialized personnel and to increase training; however, regional management admits it is still far from resolving the problem. At present, untrained employees process leases, seeking Department of Justice advice only if they see "something out of the ordinary". Errors and oversights are made because employees lack the expertise to know when a legal opinion should be obtained. Inappropriate actions, such as those resulting in the Guerin case, occur under such circumstances.

11.25 The Department of Indian Affairs and Northern Development should ensure that personnel discharging fiduciary responsibilities are properly qualified and have the training needed to fulfil their responsibilities.

__Department's response__: The Department agrees with this recommendation.

11.26 **Supervision of staff.** Another aspect of a fiduciary's duty, after choosing qualified agents, is to supervise those agents to ensure that they exercise an adequate standard of care. In administering a trust, a trustee has a duty to exercise such care and skill as an ordinary prudent business person would exercise in the management of his or her own affairs. No ordinary prudent business person would allow an agent to act without supervision or without being satisfied that the agent knew his or her responsibilities and how to fulfil them. In practice, private trust companies have policy and procedures manuals to advise employees on how transactions are to be carried out. In addition, they have systems of checks and balances to ensure that things are done when and as they should be. Sales of property, encroachments on the capital of a trust, and investments are all reviewed by several levels in the company, with the final level of approval on some of these being the executive or senior management committee. No decision is made by any one person, and virtually everything an employee does is reviewed by someone at a higher level, and usually by a specialist. We found that the Department does not provide adequate supervision to its staff and does not have adequate review mechanisms to ensure the quality of the work being performed.

11.27 The Department recognizes that a number of the problems noted above exist and is studying and trying to resolve them. However, we believe that action must be taken quickly to enable the Department to fulfil its responsibilities and to minimize its exposure to future liability.

11.28 **Qualified surveyors and appraisers.** Legal advice is only one of the areas in which specialist help is needed for land management. Reserve land has to be surveyed and often appraised before it can be leased to non-band members. This has resulted in more requests for surveys and appraisals arriving at regional offices than these offices can handle. One region advised us that $40,000 is put aside annually for appraisals. As one appraisal can cost as much as $20,000, the backlog of requests is long. Similarly, legal surveys are costly but are often necessary, and the backlog of such requests is also long. This all points to a substandard service to Indian clients and possible liability on the part of the Department should leases or revenues be lost because of excessive delays. Private companies draw on outside experts such as surveyors and appraisers when this sort of situation arises, and we believe this would also be appropriate for the Department.

11.29 **Contingent liabilities.** The Guerin case has clarified the Crown's fiduciary duties with regard to "surrendered land" of the Indians. However the existence at 30 June 1985 of some 100 other lawsuits pending against the Crown illustrates the need to intensify attention to this matter. Approximately 75 per cent of these claims have no dollar value stated, but the 25 per cent that do represent a potential liability of $1.77 billion. Many of the claims have been in existence for some time; the Guerin decision may revive them and precipitate further claims. This potential liability was brought to the attention of Parliament in the form of an audit note in our 1985 Report.

Estate Administration

11.30 Jurisdiction and authority over the estates of deceased Indians who lived on reserves are vested in the Minister of Indian Affairs and Northern Development, except where the Minister consents to a transfer to the jurisdiction of the provincial courts. This is usually done where an estate is large and involved or where the death resulted from an accident, and insurance claims are involved. Generally, responsibility rests with the Department; this means it is liable to the heirs for any irregularities or errors in its administration of an estate.

11.31 On notification of a death, the Department is required to prepare an itemized inventory of the estate, listing all real and personal property of the deceased and its value, all debts and claims against the estate, a statement as to whether the deceased left a will, and a list of all beneficiaries. It is also responsible for taking all steps necessary to safeguard the assets and collect money owing to the deceased. If the deceased has left a will and appointed an executor, the Department will be asked to approve the will and authorize the executor to act. If no will exists, the Department will appoint an administrator.

11.32 In practice, the Department prepares an inventory and safeguards the assets of an estate only in a minority of cases. This appears to be because officers of the Department do not have the time to go to reserves and take inventories themselves, particularly because many reserves are in remote locations. As a result, employees often rely on volunteers such as friends or relatives of the deceased. The problem created by this is that the Department is legally liable for the actions of volunteers. That is, it is liable for mistakes in inventories and damage or loss caused to estate assets because they were not properly safeguarded.

11.33 In the private sector, where trust companies act as executors or co-executors of their clients' estates, they take care to ensure that necessary procedures are carried out properly and promptly. Most companies have checklists of steps to be taken and a time frame that begins the moment they are advised of a death and ends when the last detail of the estate is settled. Detailed inventories are taken, appraisals are made of estate assets, assets are insured and every precaution is taken to safeguard them.

11.34 The Department's system and procedures for handling estates do not meet the standard exacted in the private sector. A report commissioned by the Department confirmed this and suggested that more resources be allotted to the estate program so that necessary safeguards can be initiated. At present, estate matters are given low priority, and resources have not been increased to meet the workload or improve the quality of administration.

11.35 **Training for estate management.** When administering Indian estates, the Crown is acting in the capacity of a fiduciary or trustee, and in this capacity must exercise a high standard of care, as discussed under Land Management. The duty to choose appropriate agents and to supervise their work is much the same as in land management. We found that, generally, personnel are not adequately trained, and expert opinions and assistance are not obtained frequently enough. There are excessive delays in processing estates. Furthermore, regulations, procedures and policies are outdated and not comprehensive enough, records are inadequate, and there is no formal system of estate administration. These problems have been pointed out in studies commissioned by the Department, but there is no evidence that the Department has taken steps to remedy them.

11.36 With respect to initial qualifications, estate officers rarely have experience in estate administration above the clerical level. Despite this lack of experience, they take on what is in effect full regional authority for estate administration as soon as they start work. They are expected to make decisions and give advice to districts with little or no access to expert advice or assistance. Their superiors have some knowledge of the larger problems of estate administration but are not familiar with day-to-day issues. Advice from headquarters and the Department of Justice in the regions is available, but many regional employees view it as not very accessible, timely or practical.

11.37 Once in their jobs, estate officers do not receive adequate training from the Department. The implications of inadequate qualifications and training are that estate officers can make serious errors that could result in legal liability for the Department without knowing they are doing so. For example, some districts officers do not have a good knowledge of the relevant provisions of the Indian Act or the Regulations. The errors committed are frequently errors of omission; estates are often left unattended because of insufficient staff or lack of knowledge of how to deal with them. In Manitoba, at present, many estates have had no action taken on them because the estate officer positions are vacant and only the clerical positions in the Estates Section are filled.

11.38 **The Department of Indian Affairs and Northern Development should ensure that employees assigned to estate administration have the knowledge and skills necessary to handle all aspects of the work.**

11.39 **Estate backlogs.** There is another serious problem in the quality of estate administration. Because of a lack of staff, delays in processing estates are excessive and backlogs become unmanageable. For example, in Ontario one person handles all estates for the regional office, assisted only by district superintendents who act as administrators. In Manitoba, two clerks are the only staff dealing with estates. In Ontario, the shortage has meant long delays in administering estates and an ever-growing backlog, which at the time of this audit amounted to 550 to 600 estates. Estates are not considered part of the backlog until they are over three years old. Some estates over 20 years old are still not settled. In Manitoba, the staff shortage has resulted in backlogs so serious that estates are often left untouched until a complaint arises. There are 300 new estates a year referred to the Manitoba regional office, which has the capacity to process only 150 estates annually when fully staffed.

11.40 In British Columbia, the situation is better as a result of a recent management review and reorganization. The region cleared its backlog and is now able to manage its workload. In addition, more qualified people are being hired in both the region and the districts, and workshops and seminars on estate matters have been developed. The region has not solved all the problems of estate administration, but it is attempting to provide a better service.

11.41 It has been suggested that the workload of estates officers could be substantially decreased if the preferential share of an estate, which goes automatically to the spouse, could be increased from the present $2,000 to the provincial limits, which range from $40,000 to $75,000. Officials of the Department see this as a possible way of streamlining administrative procedures.

11.42 The Department of Indian Affairs and Northern Development should study the question of whether estate administration procedures would be substantially improved by increasing the amount allowed for a spouse's preferential share of an estate. If the answer is positive, steps should be taken to seek the appropriate amendments to the legislation.

11.43 **Records.** We found that records kept on individual estates were inadequate. Checklists of steps to be taken did not seem to be used. The result is that it is often difficult to ascertain what steps have been taken. For example, in Ontario it was pointed out that there was no procedure for checking to ensure that cheques requisitioned for beneficiaries are made out in the proper amounts and actually sent out. Regional headquarters recognizes the problem but states that there is neither the time nor the personnel to correct it. Without proper record keeping, the defence of claims made against the Department or administrators will be difficult to prove with respect to whether and when proper steps were taken.

11.44 The Department of Indian Affairs and Northern Development should implement a checklist system for estate administration to ensure that documentary evidence exists to show that all necessary procedures are completed in a timely fashion.

> *Department's response: The Department agrees with the recommendations made on estate administration. However, with the planned reduction in the size of the Department, it will become even more difficult to provide effective administration of Indian estates. The overall approach to the management of this function is under review, both to improve existing procedures and to amend the legislation.*

11.45 To date, Indian estates have been given a low priority by the Department largely because there have been few allegations of mismanagement in estate administration. However, as bands grow wealthier and their dealings with the Crown become more complex, this may no longer be the case. The Guerin case may encourage bands to hire lawyers and launch claims against the Crown. To avoid such claims, the Department needs to ensure that it is meeting its legal responsibility to the Indian people.

Management of Indian Moneys

11.46 **Indian band funds.** The Reserves and Trusts Branch is responsible for managing Indian moneys. The Indian Act defines Indian moneys as "all moneys collected, received or held by Her Majesty for the use and benefit of Indians or bands".

11.47 Indian band funds are held in the Consolidated Revenue Fund and administered in accordance with the Indian Act. Each of these funds is divided into separate accounts for capital and revenue. The accounts were established to provide a continuing economic base for the Indians. When any part of the lands reserved for a band is surrendered and sold or leased, or when resources on reserve lands are sold, the proceeds are to be held in these accounts to finance present and future activities of the band. As prescribed in the Act, these accounts receive interest from the Government of Canada at a rate fixed by the Governor in Council. Until recently, the main source of funds in the capital accounts was the sale or lease of lands. In the past 10 years, as a result of oil and gas royalties flowing into the capital accounts of a few bands, the band fund balances have climbed dramatically.

11.48 In addition to administering the capital and revenue accounts for bands, the Department also maintains over 15,000 individual accounts for minors, unsettled estates, mentally incompetent persons and missing heirs. Most minors' trust funds originate from per capita distributions from the capital accounts of the bands.

11.49 As of 31 March 1986, there were 635 capital accounts with a total balance of over $765 million and about 592 revenue accounts with a total balance of over $47 million. These band funds constitute a liability of the Government of Canada. Exhibit 11.3 shows the number of accounts and amount of Indian moneys held by the Department at 31 March 1986.

11.50 **Revenue accounts.** The Act provides that "all Indian moneys other than capital moneys shall be deemed to be revenue moneys of the band". About 75 per cent of Indian bands have been given the authority to manage their own revenue accounts under section 69 of the Act.

11.51 This transfer of authority from the Department to bands could be seen to amount, after the decision in the Guerin case, to a delegation of responsibility for the management of the trust. In making such a delegation, the Department as trustee is obliged to exercise the same degree of care in the choice and supervision of its delegate as would a prudent business person. If this is not done, the Crown could later be liable for mismanagement by its delegate. To avoid such an occurrence, the Department needs a system and procedures for monitoring and obtaining reports on the management of revenue moneys by the bands.

11.52 **The Department of Indian Affairs and Northern Development should seek clarification of the nature and extent of its responsibility following the transfer to Indian bands of the authority to manage their own revenue accounts.**

11.53 **If the transfer to bands of responsibility for managing their revenue accounts is held to be a delegation of responsibility, the Department of Indian Affairs and Northern Development should have procedures in place to ensure that a**

Exhibit 11.3

INDIAN MONEYS HELD BY THE DEPARTMENT AT 31 MARCH 1986

		Number of Accounts	Amounts (in $ thousands)
Indian estate accounts		2,718	$ 15,090
Minors' trust accounts		14,331	98,842
Indian band funds	- revenue	592	47,174
	- capital	635	765,902
Suspense accounts		1,337	9,815
Missing heirs accounts		672	505
Adopted children accounts		3,594	5,739
Total		23,879	$ 943,067

band reports on its performance in managing the revenue moneys, or should seek amendment to the Indian Act to permit the Minister to terminate its responsibility following the transfer.

> *Department's response: The Department is reviewing this question to ensure that Bands are enabled to administer their own revenue moneys without being accountable to the Department. As part of this review, the Department is seeking clarification of the nature and extent of its legal responsibilities.*

11.54 **Capital accounts.** The Indian Act defines capital moneys as "all Indian moneys derived from the sale of surrendered lands or the sale of capital assets of a band". The Department has interpreted this to include money from the sale of land, timber and gravel and the exploitation of oil and gas.

11.55 Section 64 of the Act provides that the Minister may, where it is for the benefit of a band and with the consent of a band council, authorize expenditures from Indian capital moneys for specific purposes. Consent must come in the form of a band council resolution which requests the expenditure and initiates the expenditure process. The band council resolution forms the basis for assessment and approval of the request and the ultimate expenditure. In practice, the information provided to the Department is often inadequate. The reason for this is that there are no guidelines on what information is required, and the Department has not adequately communicated its expectations in this regard to the bands.

11.56 Furthermore, because of the time constraints set by the bands and the resource limitations of the Department, assessment of proposed expenditures is not carried out in a manner comparable to methods used by trustees in the private sector. For example, we found that the assessment process does not have standard procedures and guidelines to ensure that an expenditure is for a purpose allowed by the statute, that it is approved by an appropriate officer (as defined in procedures for delegation of authority) and that, once provided, funds are expended as authorized.

11.57 Capital moneys must be disbursed in accordance with section 64 of the Indian Act. In our 1984 Report, we stated that the Department had released funds from capital accounts on the basis of a broad and possibly inaccurate interpretation of section 64. To reduce the potential for liability to the Crown as a result of these deficiencies, we suggested that the Department follow the advice of the Public Accounts Committee and seek a judicial opinion from the courts regarding the correct interpretation of section 64. The Standing Committee on Public Accounts in its First Report dated 11 February 1985, recommended that:

- the Minister immediately seek a judicial opinion regarding the correct interpretation of subsection 64(k) of the Indian Act in order to ensure that the Crown is not exposed to any future legal liability; and
- the Department implement procedures to ensure that Indian capital moneys are professionally administered and disbursed in accordance with law.

11.58 At the time of writing this report, the Department had not acted on these recommendations.

Department's response: The Standing Committee recommendation concerns an observation by the Auditor General. It is our understanding that the statement in the Auditor General's 1984 Report (paragraph 3.58) dealing with a possible reference to the Federal Court of Canada, pursuant to section 17 of the Federal Court Act, on the scope and interpretation of paragraph 64(1)(k) is based on a letter from a former Associate Deputy Minister of Justice. This letter dealt in part with a possible administrative scheme in relation to paragraph 64(1)(k), which allows the Minister to approve expenditures of capital moneys which, in his opinion, are for the benefit of the band. it was suggested that if questions arose with respect to that scheme then this was one way to resolve them.

Section 17 has been utilized where the Crown is in dispute with another party over the effect of a statute on a particular fact situation - not just the simple interpretation of a statute.

It should also be pointed out that a decision of the Federal Court (even if possible) to a general question such as this does not bind the Court in future cases where other facts are in issue. Therefore, even if a question of this nature were referred to the Court, the value of a judicial interpretation, in relation to future proposals considered under paragraph 64(1)(k), would be limited.

As such, it is our Counsel's view that it would not be appropriate to refer the question relating to paragraph 64(1)(k) to the Federal Court. Therefore, in light *of this and of other concerns, we are examining the need for amendments to the section to clarify its scope and intent.*

Trust Accounts for Minors

11.59 With the consent of a band council, the Minister may authorize a per capita distribution to the members of a band of an amount not exceeding 50 per cent of the band's capital moneys derived from the sale of surrendered lands and from oil and gas royalties. Hundreds of millions of dollars have been distributed to individuals under this provision of the Indian Act.

11.60 Pursuant to the Indian Oil and Gas Act, all royalties from oil and gas obtained from Indian lands are held in trust by Her Majesty for the bands concerned. When the Minister, as trustee of these moneys, authorizes a per capita distribution, the payments constitute a discharge of the Minister's responsibility with respect to the royalties. For band members who are minors, however, the Minister must maintain trust accounts until they reach the age of majority. As of 31 March 1986, there were 14,331 trust accounts for minors, with a total value of $99 million.

11.61 Despite the requirement to hold a minor's share in trust until he or she reaches the age of majority, it has been the Department's practice to pay out a maximum of $3,000 a year to the minor's parents or guardian. This reflects the provision, under provincial trust laws, that the income of a trust may be paid out, on request, for the maintenance of a trust beneficiary. The program circular issued by the Department to clarify this practice states that the $3,000 payment is to be made on the written request of the parent or guardian. However, the $3,000 annual payment is made on behalf of all minors without the written request of the parent or guardian and regardless of need.

11.62 In addition to these distributions, per capita distributions are made of revenue moneys. In these cases, 100 per cent of the child's share is distributed to his or her parents or guardians.

11.63 Because of our concerns about these practices, we sought advice from an independent legal counsel, which confirmed our opinion that these funds were being released without adequate safeguards.

11.64 To comply with its fiduciary obligations, the Department should, as a minimum, make reasonable enquiries as to the need for the funds. This would involve a written request from the parent or guardian setting out the reasons why the moneys are required. Further, because court approval is necessary for such payments under provincial Trustee Acts, the Department should obtain court approval or pay the funds into court or to the Official Guardian or Public Trustee for the province.

11.65 An alternative would be to seek amendment of section 52 of the Indian Act to give express power to the Minister to advance funds for the maintenance and education of

Indian minors out of the revenue or capital moneys to which they are entitled. These provisions could be similar to those in the Act dealing with mentally incompetent Indians.

11.66 The Department of Indian Affairs and Northern Development should revise its procedures governing the payment to parents or guardians of funds held in trust for minors, so that its procedures comply with provincial trust laws, or should seek amendment of section 52 of the Indian Act to give the Minister power to advance the funds for the maintenance and education of Indian minors.

> *Department's response: The Department recognizes the problem and is seeking legal advice as to the nature and extent of its responsibility.*

Elementary and Secondary Education

11.67 The Indian Act empowers the Minister of Indian Affairs to provide specific educational services to Indian children between the ages of 6 and 17 inclusive who ordinarily reside on a reserve or on lands belonging to the Crown. Authority to manage specific educational programs comes from the Appropriation Acts, Treasury Board Minutes and Orders in Council.

11.68 The objective for the Elementary/Secondary Education activity, stated by the Department in the 1985-86 Estimates, was:

> to ensure that all eligible Indians and Inuit have access to a quality and range of elementary/secondary education that is relevant to the social, economic and cultural needs and conditions of the individuals, bands and communities being served.

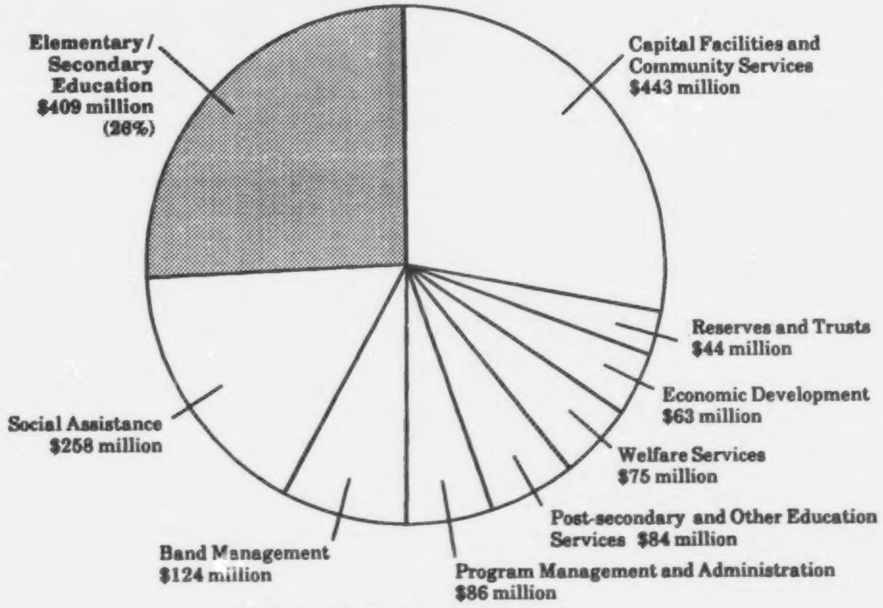
11.69 Education, along with other departmental activities, is carried out through a central administration in the National Capital Region, 7 regional offices and 37 district offices and regional service centres. The total number of children for whom education is provided in federal, provincial and band schools is approximately 80,000. As noted previously, the annual cost, excluding capital outlays, is $409 million or 26 per cent of the Indian and Inuit Affairs Program. Exhibit 11.4 shows the significance of the Elementary/Secondary Education activity relative to the other activities of the Indian and Inuit Affairs Program.

Background

11.70 **Indian control of education.** In the mid-1960s, with few exceptions, Indian students attended schools that based their programs largely on provincial curricula, which reflected the values, goals, skills, language and attitudes of the non-Indian population. Native groups and Indian parents voiced their discontent with educational programs that included little about the history, culture and values of native peoples. They claimed that, without some sense of shared experience and common purpose, education would remain irrelevant to the lives and future of Indian students. Student alienation results in poor attendance, low retention rates and lack of achievement. These were seen as symptomatic of the lack of a positive relationship between the school and the community.

Exhibit 11.4

SIGNIFICANCE OF ELEMENTARY/SECONDARY EDUCATION AS PART OF INDIAN AND INUIT AFFAIRS PROGRAM 1986-87 ESTIMATES



Total 1986-87 Estimate $1,586 million

11.71 The Department was aware of this problem and had initiated programs to facilitate community participation in enriching and modifying the curriculum. The National Indian Brotherhood, in the 1972 position paper it presented to the Standing Committee on Indian Affairs, "Indian Control of Indian Education", addressed this question. The Minister accepted the principles of the paper in 1973. However, because the Indian Act has not been amended, there is no legal basis for transferring control of education to Indian bands. Under the Act the Minister remains accountable for the quality of education delivered to Indian children.

11.72 **Departmental guidance.** The Department drafted a series of circulars on education in the mid-1970s to provide operational guidelines to its staff. The circulars were intended to explain policies, establish program standards, describe implementation procedures and set funding limits. They were also intended to be used by Indian bands that were assuming control of the process; however, they were not accepted by the bands because they had not participated in drafting them.

11.73 In 1978, the Department made another attempt to provide guidelines by publishing its educational policy and by outlining current standards and procedures to be used in the delivery of educational services. This publication was developed in consultation with Indian representatives. There was strong pressure against official acceptance of the policy from Indian political organizations and it was withdrawn. We saw no evidence of further direction on policy and procedures for the delivery of education. It has become evident that the Department's failure to establish guiding principles and program standards and to document implementation procedures has impeded the effective delivery of educational services to Indian children.

11.74 **Delivery of educational services.** Although the Department is responsible for delivering education that is "relevant to the social, economic and cultural needs and conditions of the individuals, bands and communities being served", it does this directly only for approximately 25 per cent of Indian children who go to federal schools. About 51 per cent of Indian children go to provincial schools; here, the Department's role is to provide funding and, to a limited extent, to see that their special needs are taken into account by the province and the local school board. The remaining 24 per cent of Indian children go to schools operated by bands on the reserves. The Department, in supporting Indian control of Indian education, still retains its responsibility for providing all eligible Indians with "access to a quality and range" of education relevant to their needs.

Audit Scope

11.75 The objective of our audit of this activity was to evaluate the adequacy of the Department's systems and procedures for managing the delivery of educational services. Because these services are delivered through provincial and band schools as well as federal schools, and because such a wide variety of specific needs must be served, we looked for a system that would provide clear operational direction to allow for local needs and desires to be accommodated while ensuring that minimum standards were upheld.

11.76 Also, because the Department is accountable to Parliament for both the expenditure of public funds and the results achieved, we expected to find specific and measurable goals relating to the type and quality of education to be made accessible to Indian children, educational programs and procedures to achieve the stated goals, and a reliable information system that would allow management to monitor results and report on them.

11.77 We also examined the devolution process for transferring the management of Indian education to Indian organizations.

Lack of Direction

11.78 **Introduction.** Provincial education acts and regulations provide a clearly defined management framework within which provincial education jurisdictions must carry out their managerial and professional responsibilities. The relevant sections of the Indian Act under which education to Indians is provided do not define education or provide any direction for its delivery. This means there is no firm basis on which a coherent and consistent policy on education can be formulated. In a 1982 study, the Department carried out an assessment of its system of delivering education to Indian children and found that many of its problems were directly related to the lack of explicit operational and policy guidelines.

11.79 The provinces have primary responsibility for education and for determining standards within their jurisdictions. The Department, as a general rule, adopts the basic provincial core curricula to ensure that the principle of mobility is maintained. However, it must adapt certain areas of the program of studies and modify them to meet the special linguistic and cultural needs of Indian children. We found the adaptation of provincial programs by federal and band operated schools is largely uncoordinated. This is partly due to the fact that subjects of instruction other than core subjects are very much tailored to the specific needs of the community and, therefore, do not lend themselves to a standardized approach.

11.80 This practice leads to duplication of effort in developing curricula, and the quality of the programs that are developed outside the provincial systems is not consistently controlled. For provincial schools, the Department's role is to enter into tuition agreements with provinces or school boards to provide education to Indian children.

11.81 For the provincial programs, we found that the Department does not have the capacity to assess them in a systematic and co-ordinated way. There was little Indian involvement in the design, delivery, administration, control, review and evaluation of provincial education programs as they relate to Indian children.

11.82 **Standards and operational guidelines.** We found that although it is recognized departmental practice to apply provincial education standards for Indian schools, there was no formal statement to that effect. There were only limited written operational guidelines for managing schools, developing curricula or delivering the educational program. In some regions, standards and guidelines have been developed by regional management. In a number of program delivery areas, however, implementation and monitoring are the responsibility of regional offices that have no standards or operational procedures to assist them.

11.83 Lack of agreement, along with pressure from Indian political organizations, led the Department to abandon its attempts to provide formal management direction in the late 1970s. Thus, the Department has had to continue in its management role without program standards or implementation procedures. This has limited the Department's ability to assess its own performance. As a result, there is no assurance that it is meeting its objective of providing all eligible Indian children with the "quality and range" of education relevant to their needs.

11.84 **The Department of Indian Affairs and Northern Development should develop operational standards, guidelines and procedures for its regional and district offices to follow. It should also introduce a monitoring system to provide feedback to various levels of management on the quality and level of educational services actually delivered by federal and band operated Indian schools and the educational achievements of Indian children.**

Information Systems

11.85 The Department maintains two nation-wide information systems on education. They are the Nominal Roll – an annual count of all eligible Indian children registered in school in early October – and the Education Data Base – a system for financial planning and allocation of funds.

11.86 The Nominal Roll includes general information for each child – residency, band registration, type of school attended and grade of registration – and educational information such as early school leaving or special education. To eliminate the possibility of duplicate recording of names, all students' names are cross-referenced against the band membership lists. This information system provides the basis for unit counts of students in the Education Data Base and for reports on system participation.

11.87 Given the diversity of management practices in the program, we found that there were no systematic procedures in place to collect data at the field level or to verify data input, resulting in inefficiency in data collection and use. There was also no assurance that collected data were accurate.

11.88 **Program effectiveness information.** For the Department to administer the educational program properly, to monitor its progress and to evaluate its effectiveness, it needs reliable information on a number of educational elements. Factors such as school retention, number of graduates, and participation rates provide some measure of the overall effectiveness of the schools. For program evaluation purposes, it also needs to have information on such things as the impact that has been produced by additional expenditures or how curriculum modifications have narrowed the gap in educational achievement between Indian and non-Indian children.

11.89 Since the generally accepted testing instruments used by most educational jurisdictions are based on urban populations, these are not considered to be educationally appropriate for Indian children living essentially in rural and isolated areas. As a result, schools have often restricted the use of testing.

11.90 We found that there were no uniform data or statistics on the academic achievement of Indian children in relation to specific educational program initiatives. Consequently, the Department could not evaluate the overall effectiveness of the education program or the effectiveness and performance of federal and band-operated schools. The lack of reliable information also prevented effective needs assessment and made it virtually impossible to measure progress in such areas as educational achievement of Indian students.

11.91 **Financial information.** The Education Data Base is a system that has been used by the Department for the past five years for financial planning and allocation of funds. The planning process is carried out twice a year – in June, to obtain additional funding where there have been changes in costs and volumes, and in November, to plan the level of funding required for the next fiscal year and make adjustments in costs and volumes for the current year.

11.92 The definitions of services are so broad that they allow different interpretations by district or regional offices, with the result that the services cannot be compared. As an illustration of this lack of consistency among provinces, some regions define instructional services as including the band's director of education, while other regions include guidance counsellors in the definition, although under departmental policy neither should formally be included in the category of instructional services. Because of these deficiencies it was not possible to develop a reliable data base. Regions and districts were not ensuring that the Education Data Base reflected the budget requirements of all schools, as provided by the schools themselves. Furthermore, it was not being used by the Department to allocate required resources to schools.

11.93 Work has been undertaken in the Department to improve the functioning of this data base. Individual managers in the regions are attempting to take corrective action, independently from headquarters. Headquarters is also studying means to improve the system or develop a new system. Without reliable financial information, the Department cannot determine whether funds appropriated for education programs are being used with due regard for economy, efficiency and effectiveness.

11.94 The Department of Indian Affairs and Northern Development should expand the information in its Nominal Roll to include information such as achievement levels relating to quality and range of education.

11.95 The Education Data Base should be improved by ensuring that a consistent definition of services is used and that budget requirements are developed at the school level and used for financial planning and a more equitable allocation of resources.

Devolution

11.96 The Government stated in 1973 that its policy regarding Indian education was to support "Indian control of Indian education". The Department has not defined what it meant by "Indian control". It was not clear whether this meant that Indian organizations would merely operate and administer the schools under policies and regulations established by the Department or that they would be free to exercise their responsibility and decision-making capacity as would an elected school board in the provincial systems.

11.97 The Department has not defined the steps leading to devolution. As a result, there appears to be a considerable gap between what the Indian organizations expect and how much the Department is prepared to devolve.

11.98 The Department has not established criteria or a checklist to ensure that an appropriate infrastructure, which would enable a band to administer and operate a school, is in place before it transfers control to an Indian organization. Because there were no clear policies, procedures or operational guidelines and since there was no mutual understanding of the mechanics of band takeover and operation, transfer arrangements have been a contentious issue.

11.99 The Department of Indian Affairs and Northern Development should define "Indian control" in order to make it clear whether the Indian organization assuming control is carrying out an administrative or a management role. The Department should develop clear policies and procedures for transferring control of education to Indian organizations.

Native Claims

Introduction

11.100 In a statement to the House of Commons on 8 August 1973 on the claims of Indians and Inuit, the Minister of Indian Affairs stated that the Government of Canada recognized two broad classes of native claims - comprehensive and specific. Comprehensive claims are based on the notion of aboriginal title. Specific claims relate to the administration of Indian land and other assets, such as Indian moneys under the Indian Act, and to fulfilment of Indian treaties (Exhibit 11.5) or other agreements.

11.101 The Department provides financial assistance to native groups for researching and negotiating land claims. It has provided about $35 million in the past 13 years in the form of contributions for research into Indian and Inuit rights, treaties and claims. Another $99 million has been provided to native claimants in the form of recoverable loans.

Audit Scope

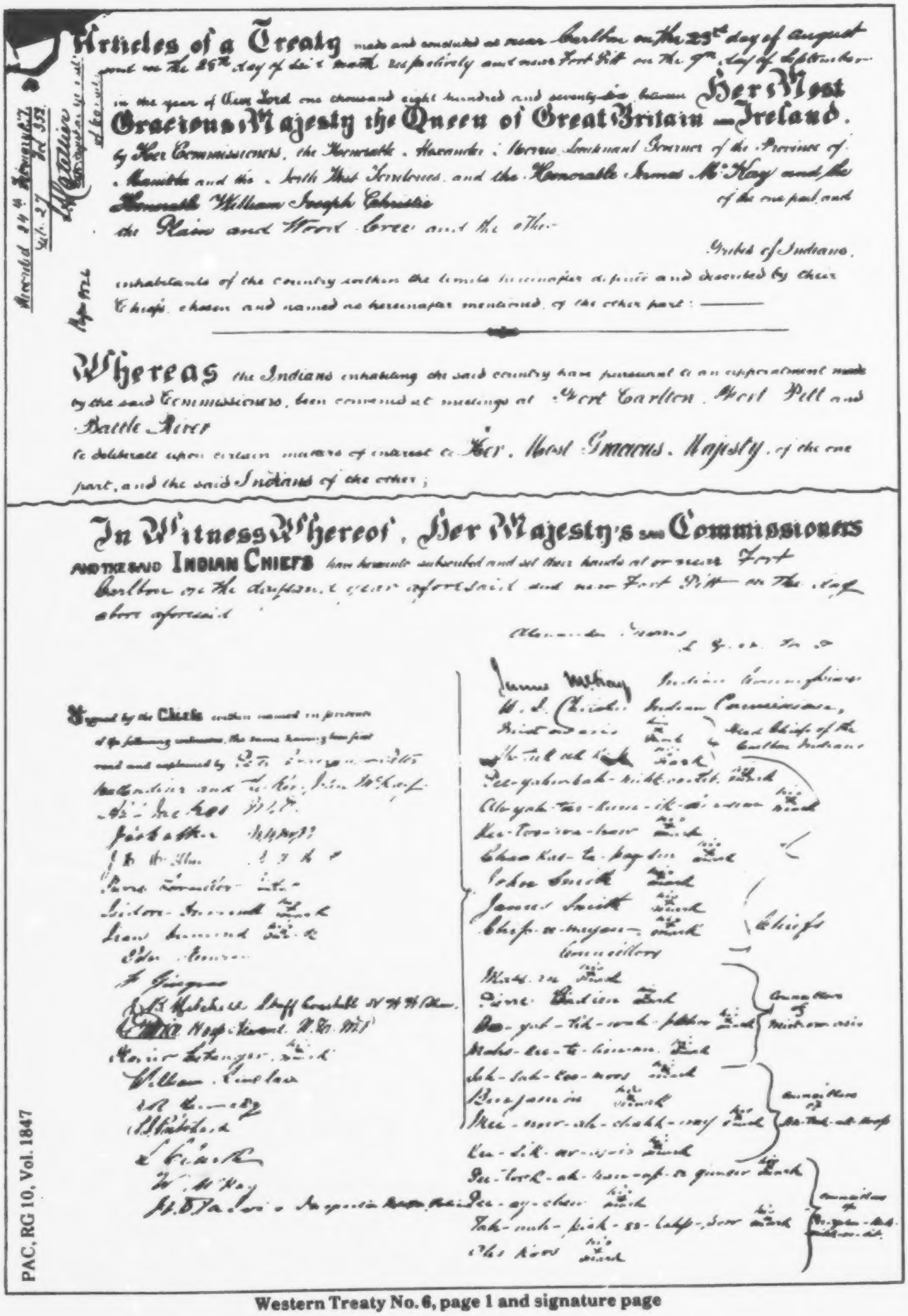
11.102 We selected one of the three comprehensive claims that have been settled, and reviewed the implementation activities that led to the agreement. Although we did not look at any specific claims in detail, we examined the management processes for providing financial assistance to native claimant groups for research, development and submission of both comprehensive and specific claims and for providing loans to support native claimants in the negotiation process.

Comprehensive Claims

11.103 The government's policy and objectives for comprehensive claims are set out in the document *In All Fairness*, published by the Department in 1981. The three fundamental points are:

> ... the government requires that the negotiation process and settlement formula be thorough so that the claim cannot arise again in the future. In other words, any land claim settlement will be final.
>
> The negotiations are designed to deal with non-political matters arising from the notion of aboriginal land rights such as lands, cash compensation, wildlife rights, and may include self-government on a local basis.
>
> The thrust of this policy is to exchange undefined aboriginal land rights for concrete rights and benefits. The settlement legislation will guarantee these rights and benefits.

Exhibit 11.5



Recorded 24th January 77 Lib. 27 Fol 353 [illegible]

Articles of a Treaty made and concluded at near Carlton on the 23rd day of August and on the 28th day of said month respectively and near Fort Pitt on the 9th day of September in the year of Our Lord one thousand eight hundred and seventy-six between **Her Most Gracious Majesty the Queen of Great Britain and Ireland**, by Her Commissioners, the Honorable Alexander Morris Lieutenant Governor of the Province of Manitoba and the North West Territories, and the Honorable James McKay and the Honorable William Joseph Christie of the one part, and the Plain and Wood Cree and the other Tribes of Indians, inhabitants of the country within the limits hereinafter defined and described by their Chiefs, chosen and named as hereinafter mentioned, of the other part: ——

Whereas the Indians inhabiting the said country have pursuant to an appointment made by the said Commissioners, been convened at meetings at Fort Carlton, Fort Pitt and Battle River to deliberate upon certain matters of interest to Her Most Gracious Majesty, of the one part, and the said Indians of the other;

In Witness Whereof, Her Majesty's said Commissioners and the said INDIAN CHIEFS have hereunto subscribed and set their hands at or near Fort Carlton on the day and year aforesaid and near Fort Pitt on the day above aforesaid.

Alexander Morris L. G. N. W. T.

James McKay Indian Commissioner

W. J. Christie Indian Commissioner

Signed by the Chiefs within named in presence of the following witnesses, the same having been first read and explained by Peter Erasmus, Peter Ballendine and the Rev. John McKay:

A. G. Jackes M.D.

[illegible]

J. H. McIllree

Pierre Levailler his mark

Isidore Dumond his mark

Jean Dumond his mark

[illegible]

F. Gingras

R. B. Mitchell Staff Constable N. W. M. Police

[illegible] Hosp. Steward N. W. M. P.

Xavier Letanger his mark

William Sinclair

[illegible]

[illegible]

[illegible]

W. McKay

[illegible]

[illegible] his mark, [illegible] his mark — Head Chiefs of the Carlton Indians

Pee-yahn-kah-nikk-oo-sit his mark

Ah-yah-tus-kum-ik-im-am his mark

Kee-too-wa-haw his mark

Chaa-kas-ta-paysin his mark

John Smith his mark

James Smith his mark

Chip-ee-way-an his mark

Chiefs

Councillors

[illegible] his mark

Pierre Cadien his mark

Oo-yah-tik-wah-pahn his mark

Mahs-kee-te-timan his mark

Councillors of Mistowasis

[illegible] his mark

Benjamin his mark

Mee-noo-ah-chahk-way his mark

Kee-[illegible] his mark

Councillors of Ah-tuk-uk-koop

Pee-took-ah-haw-nap-ee-gin-ew his mark

Pee-ay-chew his mark

Tah-wah-pisk-ee-kahp-pow his mark

[illegible] his mark

Councillors of [illegible]

PAC, RG 10, Vol. 1847

Western Treaty No. 6, page 1 and signature page

11.104 The James Bay and Northern Quebec Agreement provides for cash compensation totalling $232.5 million ($34 million from the federal government and $198.5 million from the Quebec government) and for specific native interest in land use. It also contains some specific obligations.

11.105 However, many important provisions relating to these specific obligations are not precise enough to commit Canada to specific levels of service or funding, or to achieve goals by a defined date. For example, the agreement states that for each Cree community, Quebec and Canada shall provide funding and technical assistance for a) the construction or provision of a community centre, b) essential sanitation services and c) fire protection facilities and equipment. However, this assistance is "subject to the extent of financial participation possible by Canada and Quebec", and neither government is committed to achieving these goals within a given time frame.

11.106 At the federal level, DIAND has overall responsibility for the agreement and is responsible for implementing specific sections. Several other departments are involved, including Environment, Secretary of State, Transport, Health and Welfare, Employment and Immigration, Regional Industrial Expansion and the Canada Mortgage and Housing Corporation. These departments and agencies participated in negotiating sections of the agreement relating to them, but their commitments to meet their obligations vary considerably.

11.107 It is essential that one department be responsible for co-ordinating implementation of agreements. Although this is DIAND's role, we found that the Department cannot exert enough influence over other federal departments and agencies to ensure that they will fulfil their obligations under the agreements.

11.108 The fact that government obligations were included in the agreement raised native expectations that they would be carried out within a reasonable time. However, the lack of specificity, the failure to dedicate resources to the obligations, and the fact that obligations were not always assigned to a specific department through an approved implementation plan have caused serious problems in implementing parts of the agreement. The Department has estimated that the cost in current dollars of implementing the outstanding obligations would be $190 million. As a result of a joint review of the implementation of the agreement by the Minister of Indian Affairs and the Minister of Justice in 1982, Cabinet approved increased funding of $61.4 million over the period 1982-83 to 1986-87 to satisfy some of the obligations in the agreement.

11.109 When negotiating future settlements of native claims, the Department of Indian Affairs and Northern Development should ensure that the formal agreement is supplemented by a detailed implementation plan. The plan should specify all obligations, assign responsibilities and make reasonable estimates of timing and costs. To ensure that Cabinet is aware of every provision in the agreement, what commitments are implied by these provisions, and the cost implications of those commitments, the Department should provide an implementation plan for its review before the final agreement is approved.

11.110 **Reporting to Parliament.** Section 10 of the James Bay and Northern Quebec Native Claims Settlement Act requires the Minister of Indian Affairs to submit to the House of Commons an annual report on the implementation of the provisions of the Act for the relevant period. The report is to be submitted within 60 days after the first day of January every year from 1978 until 1998 inclusive.

11.111 We expected to find eight annual reports, but found only one tabled 18 November 1980 and the 1982 implementation review, tabled on 8 July 1982.

11.112 We were informed that a draft report has been prepared by the James Bay and Northern Quebec Secretariat for the years 1982-85 inclusive; however, it has not been presented to Parliament.

11.113 The Department has failed to comply with the legislation; this has meant that the reporting mechanism, which would enable Parliament to monitor the implementation of claim settlements, has been missing.

11.114 **The Department of Indian Affairs and Northern Development should comply with the requirements, as stated in paragraph 10 of the James Bay and Northern Quebec Native Claims Settlement Act, to table in Parliament an annual report on the implementation of the James Bay and Northern Quebec Agreement.**

Financial Assistance for Claims

11.115 An Indian group wanting to obtain funding for either specific or comprehensive claims must submit workplans and budgets, which are analysed by the Department. Funds are then allocated from the available appropriations. An agreement is signed, detailing the specifics of the funding or loan repayment and requiring submission of documentation by the group. Previous departmental audits have identified problems such as an inadequate financial recording systems, promissory notes not being received before loan funds are disbursed, and loans not being recovered from claim settlements. These problems have been corrected and the Department appears to be monitoring the claims process adequately to ensure that funding amounts are reasonable.

Northern Affairs Program

The Federal Role in the North

11.116 The objective of the Northern Affairs Program (NAP), as stated in Part III of the 1985-86 Estimates, is "to advance the social, cultural, political and economic development of the Yukon and Northwest Territories, in conjunction with the territorial governments and through co-ordination of activities of the federal departments and agencies, with special emphasis on the needs of native northerners and the protection of the northern environment."

11.117 The federal government still retains ownership of the land in the North: it owns most of the land and resources north of the 60th parallel. Under the NAP, the Department, as the government's primary agent in designing and delivering social, cultural and economic development programs, acts much as a provincial government, and is unique in the federal system. Most of the activities it is involved in are governed by statute.

11.118 **Transfer of responsibility.** Although the Department bears the major responsibility for the North, several other departments, such as Environment, Fisheries and Oceans, Transport and National Health and Welfare, have significant roles. In addition, a significant amount of authority and responsibility is delegated to the territorial governments by the Minister of Indian Affairs and Northern Development to administer their respective territories. The Northern Affairs Program is constrained by uncertainty about the extent of its responsibilities within the federal system, particularly in relation to transferring them to the territorial governments. And, like a provincial government, it has to balance the competing and often incompatible demands of people, resources and the environment.

11.119 The NAP's resources totalled $127.7 million and 870 person-years in 1985-86. Of this, $9.4 million and 123 person-years were allocated to the Canada Oil and Gas Lands Administration (COGLA). The remaining $118.3 million and 747 person-years were spread across a variety of activities, many of which are connected with control of resources.

11.120 The Department also makes transfer payments to the territorial governments. In 1985-86, these totalled $440 million for the Northwest Territories (NWT) and $138 million for the Yukon.

Audit Scope

11.121 This Office has not previously carried out a comprehensive audit of the Northern Affairs Program. In this audit, we examined the major management systems, practices and controls associated with two economic development projects – Nanisivik Mine in the NWT and Cyprus Anvil Mine in the Yukon. We reviewed the management of renewable resources and associated environmental protection activities. We did not examine transfer of resources to COGLA, the resources allocated to northern roads, or transfer payments to the territorial governments. The first two of these will be audited separately; for transfer payments, this Office carries out annual attest audits.

Economic Planning and Development

11.122 **Nanisivik Mine.** In the early 1970s, at the request of Nanisivik Mines Ltd., the federal government agreed to commit a total of $24.4 million of assistance so that a lead-zinc mining operation at Strathcona Sound, North Baffin Island, NWT, could be brought into production. This assistance involved providing a Class B Arctic airport and public dock ($8.3 million from the Department of Transport), 21 miles of road ($3.2 million from the Department of Indian Affairs and Northern Development) and, through the government of the NWT, townsite design and construction ($12.9 million). Of the total, $6.5 million is recoverable. Exhibit 11.6 shows the co-ordinating and monitoring process for Nanisivik Mines Ltd.

11.123 In consideration for this assistance, the government received shares representing an 18 per cent interest in the company. As of 31 March 1985, the company had retained earnings of over $57 million. An engineering study conducted for the Department in 1985 estimated that these retained earnings would amount to $70 million by the end of the mine's useful life, based on the company's current financial position and measured in terms of the discounted value of projected cash flows. On a strict percentage basis, the government's 18 per cent share is currently estimated at about $10 million based on certain assumptions about the future price of zinc.

11.124 In granting this assistance, the government's objectives were to promote northern development, generate employment opportunities and other benefits for northern residents, acquire expertise in operating resource projects in the Arctic, and advance Canada's role in Arctic shipping.

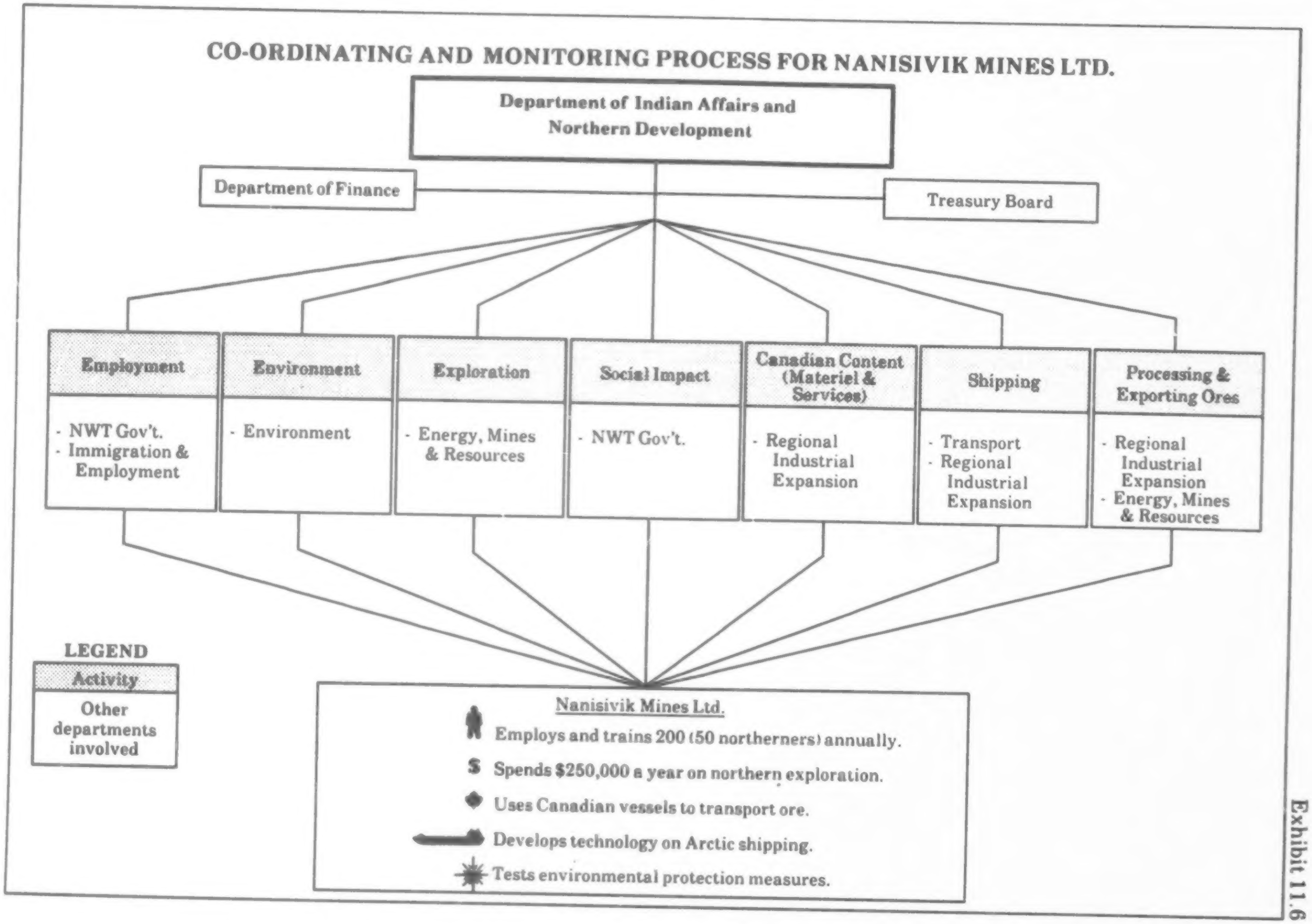
11.125 We examined the significant management systems, practices and controls associated with the project and found them to be satisfactory.

11.126 We noted, however, that the 18 per cent share of Nanisivik Mines Ltd. acquired by the government in exchange for its financial assistance was not reported in the 1984-85 Public Accounts. It may be difficult for the government to realize the value of this asset because its minority interest does not enable it to require that the funds be paid out. Nevertheless, it is an asset of Canada.

11.127 **The Department of Indian Affairs and Northern Development should ensure that the government's interest in Nanisivik Mines Ltd. is included in the Statement of Assets and Liabilities of the Public Accounts of Canada.**

11.128 **Cyprus Anvil Mine.** Before mid-1982, the Cyprus Anvil Mining Corporation's mine at Faro, Yukon, directly provided about 740 jobs annually and, both directly and indirectly generated, about 40 per cent of the Yukon's gross territorial product. In mid-1982, the mine encountered financial difficulties and ceased operation. These difficulties resulted from an excessive debt burden, high operating costs (the result of failing to remove enough rock overburden to allow for continuous mining of ore), and the decline in international lead and zinc prices in 1981. To keep the mine viable and operating, thereby supporting the Yukon economy, the government provided financial assistance. In 1983, the government agreed to provide up to $25 million of assistance to keep the mine operating and ensure continued employment. Of this, $19.6 million was an interest-free recoverable loan; the remaining $5.4 million was a contribution made through normal program funds. Government's assistance was to finance 50 per cent of the cost of removing 8.6 million cubic yards of additional overburden, thereby returning the mine to its viable long-term stripping ratio. It was to provide employment for 210 people for two years.

Exhibit 11.6



CO-ORDINATING AND MONITORING PROCESS FOR NANISIVIK MINES LTD.

Department of Indian Affairs and Northern Development
Department of Finance
Treasury Board
Employment
- NWT Gov't.
- Immigration & Employment
Environment
- Environment
Exploration
- Energy, Mines & Resources
Social Impact
- NWT Gov't.
Canadian Content (Materiel & Services)
- Regional Industrial Expansion
Shipping
- Transport
- Regional Industrial Expansion
Processing & Exporting Ores
- Regional Industrial Expansion
- Energy, Mines & Resources
LEGEND
Activity
Other departments involved
Nanisivik Mines Ltd.

Employs and trains 200 (50 northerners) annually.

$ Spends $250,000 a year on northern exploration.

Uses Canadian vessels to transport ore.

Develops technology on Arctic shipping.

Tests environmental protection measures.

11.129 We examined the significant management systems, procedures and controls relating to this assistance, and found them to be satisfactory.

11.130 We found that the strip-mining program was successful. Rock overburden was moved in greater quantity, at a faster rate and at less cost than the Mine Re-opening Plan had called for. Only $17.3 m of the loan was used.

Renewable Resource Management and Environmental Protection Management

11.131 **Renewable resource management.** The Program administers four Acts and the related regulations dealing with use and disposition of land, water and forests in the North. The central processes for management are screening by departmental officials or advisory committees, comprising all major interest groups, of any proposals for resource use; issuing appropriate permits and stipulating operating conditions; and monitoring adherence to these conditions through inspection. The Program also administers the federal Environmental Assessment and Review Process (EARP) in the North, conducts and finances research on northern renewable resources, and has recently instituted a land use planning system.

11.132 In 1984-85, this activity used $40.8 million and 359 person-years – 26 per cent of NAP expenditures, excluding grants and contributions, and 43 per cent of its person-years. We looked at the Department's compliance with the legislation and the EARP.

11.133 We did not find any major weaknesses in the regulatory and monitoring systems relating to the renewable resource responsibilities of the Northern Affairs Program. However, the systems have so far had only fairly routine situations to cope with. The one major project it has had responsibility for – the Norman Wells Pipeline – was relatively small on the scale of projects in the North.

11.134 A key to the continuing ability of the NAP to meet future expansion successfully will be to develop a mechanism for effects monitoring. In this context, effects monitoring means analysing the conditions imposed on operators through permits to determine whether they are having the intended result and, if not, determining how to modify the conditions to achieve the desired result. This activity is just getting under way, primarily because only in the last few years have there been sufficient data to permit such analysis.

DEPARTMENT OF INSURANCE

DEPARTMENT OF INSURANCE

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12

DEPARTMENT OF INSURANCE

Overview

12.1 The Department of Insurance is responsible for protecting the public against financial losses from the operations of federally registered or licensed financial institutions and pension plans. It regulates some 560 insurance companies, trust and loan companies, investment companies and co-operative credit societies with total assets of over $200 billion, and over 750 employer sponsored pension plans with assets of $28 billion (see Exhibit 12.1). The Department also provides actuarial services to the federal government, principally in the area of pension programs.

12.2 The Department is organized into three branches: Operations, Actuarial, and Finance and Administration. It has a staff complement of 226, of which 154 are located in Ottawa with the remainder in 5 regional offices. Toronto is the largest regional office with about 55 people (see Exhibit 12.2).

12.3 Of the total program expenditures of $19 million incurred by the Department during 1985-86, $7 million related to special expenses with respect to the liquidation of failed insurance companies. At present, 100 per cent of these special expenses and approximately 85 per cent of total departmental operating costs are recovered from the entities it regulates and from government organizations.

12.4 There have been a number of recent events that have affected the operations of the Department.

12.5 **Failures of financial institutions.** Since 1980, 16 companies with assets approximating $2 billion, which were under the regulation of the Department of Insurance, have failed. Moreover, in 1985 there were failures of two Canadian chartered banks, which were regulated by the Inspector General of Banks. This has resulted in several major and far-reaching reviews of the regulation of Canadian financial institutions at both the federal and provincial level.

12.6 The reports arising from these reviews have recommended significant changes in the legislative and administrative environment in which financial institutions operate. While their recommendations differ in some respects, they all express the opinion that the role of the federal regulators should be strengthened. Thus, implementation of certain of these recommendations could involve significant changes in the way in which the Department of Insurance is organized and operates.

Exhibit 12.1

Canada Trust

PENSION FUND SOCIETY
OF
THE ROYAL BANK OF CANADA

FEDERAL COMPANIES AND PENSION PLANS SUPERVISED BY THE DEPARTMENT OF INSURANCE AT 31 DECEMBER 1985

Companies [1]	Number	Total Assets ($ billions)
Life Insurance	195	$ 105.5
Property and Casualty Insurance	264	16.6
Trust and Loan	66	89.2 [2]
Investment	27	12.3
Co-operative	7	4.5
	559	$ 228.1
Pension Plans	756	$ 27.7

[1] Includes both Canadian and foreign companies.
[2] Excludes estate, trust and agency funds of $94.2 billion.

Source: 1985 departmental annual report data.

Assurance-vie Desjardins

le fonds de pension
de BELL CANADA

Ætna
CANADA

STANDARD
TRUST

London Life

Royal Insurance
Canada

Central Trust

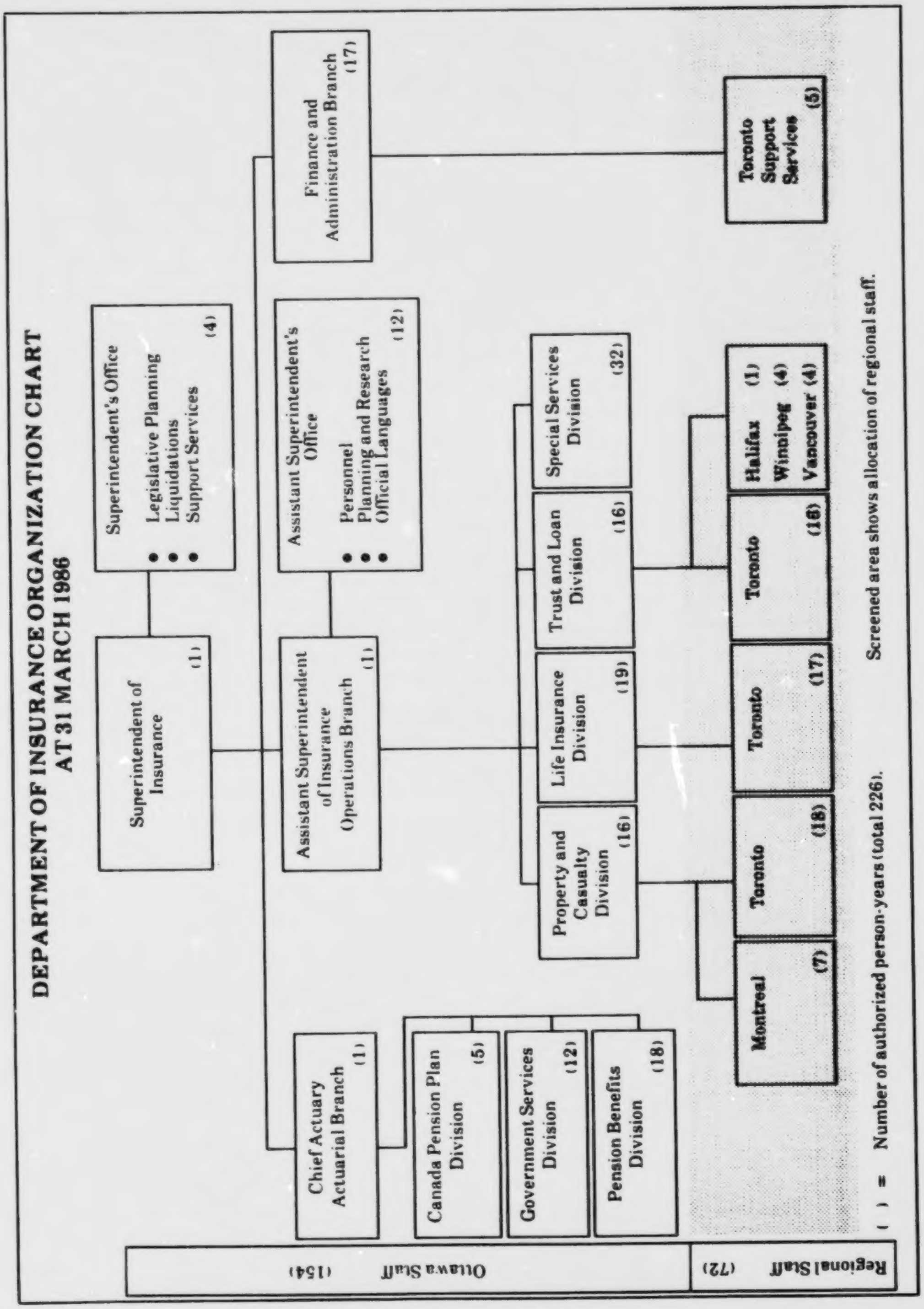
Illustrated is a random selection of companies and pension plans the Department supervises.

12.7 **Pension reform.** The Department's Actuarial Branch has been heavily involved in the pension reform process over the past several years. This is because of its role as administrator of the Pension Benefits Standard Act (PBSA) and provider of actuarial services to all federal pension programs, both public and employer sponsored. Moreover, two new pieces of legislation will significantly increase the workload of the Branch. The first deals with amendments to the PBSA, which will require additional monitoring activity by the Department; the second will require more frequent and timely reporting of actuarial information on federal pension programs.

Audit Scope

12.8 Our audit focused on the Department's principal activities – the supervision of financial institutions and pension plans and the provision of actuarial services – and on the management processes that support them.

Exhibit 12.2



DEPARTMENT OF INSURANCE ORGANIZATION CHART AT 31 MARCH 1986

Superintendent of Insurance (1)
Superintendent's Office
• Legislative Planning
• Liquidations
• Support Services
(4)
Assistant Superintendent of Insurance Operations Branch (1)
Assistant Superintendent's Office
• Personnel
• Planning and Research
• Official Languages
(12)
Finance and Administration Branch (17)
Chief Actuary Actuarial Branch (1)
Canada Pension Plan Division (5)
Government Services Division (12)
Pension Benefits Division (18)
Property and Casualty Division (16)
Life Insurance Division (19)
Trust and Loan Division (16)
Special Services Division (32)
Montreal (7)
Toronto (18)
Toronto (17)
Toronto (18)
Halifax (1)
Winnipeg (4)
Vancouver (4)
Toronto Support Services (5)
Ottawa Staff (154)
Regional Staff (72)

( ) = Number of authorized person-years (total 226).

Screened area shows allocation of regional staff.

12.9 We reviewed the major aspects of the Department's supervision activities. These include incorporation, registration, licensing, analysis, field examinations, review of actuarial reserves, and control of assets. We also reviewed the procedures in place to monitor the liquidation of troubled companies and assessed the quality of information provided to Parliament in annual reports. Finally, we sought the views of senior industry representatives on their perspectives of the Department.

12.10 We also reviewed the recent work by internal audit in the Operations and the Finance and Administration Branches and took into account their findings in formulating our observations and recommendations.

Supervision of Financial Institutions

12.11 The monitoring of financial institutions is the Department's principal activity. Over 70 per cent of the Department's staff are devoted to this work. Exhibit 12.1 shows, by industry group, the total number of companies and assets supervised. The activity is organized into four divisions.

12.12 The Life Insurance, Property and Casualty, and Trust and Loan Divisions are responsible for supervising their respective industries. In these divisions, a headquarters staff of 50 carries out work related to incorporation and other corporate changes, registration, complaints and enquiries, financial analysis and review of actuarial reserves. The field examiners, located outside Ottawa in those regions where the headquarters of financial institutions are situated, are responsible for carrying out on-site reviews of the companies. Some 50 of the 67 examiners are located in the Toronto regional office, the remainder in the other regions. The Toronto operations are segregated into the three industry divisions, each headed by a Chief Examiner who reports to the division director in Ottawa. By and large, the three examination units work independently of each other, and there is limited exchange of staff. However, the three chiefs meet on a regular basis to review operational and administrative matters.

12.13 The fourth division, the Special Services Division, serves the others by compiling financial and statistical data for inclusion in annual reports to Parliament and by monitoring the eligibility and safekeeping of company assets.

12.14 In addition, a senior officer is responsible full-time for overseeing the liquidation of insolvent companies.

Recent Initiatives

12.15 The Department attributes the failures of trust and loan companies and property and casualty insurance companies to a combination of the following factors:

- inadequate capital and surplus (equity) requirements;

- self-dealing activities that were intended to benefit holding companies and shareholders at the expense of the financial institutions;

- abandonment of sound underwriting practices in mortgage lending and real estate development, particularly in Western Canada where a significant drop in real estate values occurred during the recent recession;

- intense competition in the property and casualty industry that resulted in premium pricing wars, lowering of traditional underwriting standards and other market-driven activities undertaken to maximize cash flows; and

- poor management practices.

12.16 It should be noted that the Department had identified these problems at an early date and had taken action to deal with them. Some of its action helped to avoid company failures. For those failures that did occur since 1980, the government had advance warning.

12.17 Moreover, the Department recently took steps to strengthen the quality of its surveillance function. Some of the more important were:

- applying stricter criteria for incorporation of new companies, requiring:
    - higher initial capitalization,
    - intensified scrutiny of business plans,
    - screening of the principals by obtaining character references and assessing experience in operating financial institutions;
- introducing and continuing to improve and refine early-warning tests;
- increasing the number of people involved in the examination process, including establishing specialty positions in the claims and reinsurance areas and two actuarial positions;
- using real estate appraisers to examine values of property holdings; and
- establishing stricter guidelines for field examinations, including closer monitoring of related party transactions.

12.18 In April 1986, the Government introduced draft legislation (Bill C-103) to strengthen regulatory powers over trust and loan companies. The proposed legislation would allow the Minister of Finance to prohibit any transfer in ownership of companies that is considered to be against the public interest, allow the Superintendent of Insurance to take earlier action when problem situations occur, and give the Superintendent power to revise the values placed on real estate. In June 1986, the Government introduced legislation (Bill C-123) similarly intended to strengthen regulatory control over insurance companies.

Assessing Financial Solvency

12.19 The actions taken by the Department because of the recent failures have resulted in making its supervisory function stronger. Improved procedures for reviewing applications, together with the increased equity requirements, should go a long way toward preventing the entry of potentially unviable new companies into the industries.

12.20 Introducing better early-warning tests, redirecting its analysis and examination work to give priority to problem companies, and adding reinsurance, actuarial and real estate appraisal expertise to its examination staff have helped the Department to improve its monitoring of financial risk areas. It is very aware of the factors and problems that led to the recent insolvencies and is carefully monitoring existing companies for similar signs.

12.21 These initiatives are a good start, but the Department needs to do much more to strengthen its process for determining and assessing financial risk. For instance:

- At the time of our audit, the Department was carrying out increased surveillance activities in over 30 per cent of the financial institutions it regulates. However, the formal process for determining what constitutes a potentially risky company and for recommending to the Minister when a restricted licence should be issued, and for how long, had not been formalized and fully documented.

- There is little documented evidence to indicate that risk areas (such as solvency deficiencies, reinsurance arrangements, asset/liability mismatches) were being adequately considered in planning field examinations or how well and to what extent risks were being assessed during the examination so that managers can fully evaluate whether all such areas were properly identified and reviewed.

- There are areas in the examination function where the Department needs special expertise to help it gain a more in-depth knowledge of the industry. One area is the management and underwriting of risk by insurance companies, about which examiners have only limited knowledge.

- Little time was being directed to reviewing anticipated industry trends and potential new areas of risk. As a result, the Department may not be able to deal adequately with new and changing situations in the community. As much as 50 to 100 per cent of senior management time for periods of up to several months was being directed to dealing with company failures and the fallout from them. Coping with this and other outside pressures has left managers in the industry divisions with little time to assess future risks, let alone deal with regular, ongoing supervisory activities. In another instance, the Special Services Division, which is responsible for monitoring eligibility of all investments held by financial institutions, devotes little time to reviewing and evaluating the impact of market changes on the financial position of supervised companies and whether changes are required in criteria for determining what constitutes an eligible investment.

12.22 In our opinion, unless the Department devotes more effort to anticipating and analysing future industry trends and putting in place a better process for documenting, reviewing and assessing areas of potential risk, it may be placing itself in a position where it will not be able to detect financial problems early enough to aid in avoiding them.

12.23 **The Department of Insurance should improve its process for monitoring and assessing financial solvency of the companies it regulates. In particular, it should:**

- **document and evaluate the process for determining what constitutes a potentially risky company and what action should be taken as a result;**
- **require better documentation of risks considered and evaluated during field examinations so that management can be assured that all major risks were assessed;**
- **identify known and potential risk areas and assess whether it has the expertise and knowledge to evaluate them adequately; and**
- **ensure that more time is devoted to reviewing and assessing future industry trends.**

Department's response: The Department recognizes the importance in an everchanging environment of continuing to improve its processes for monitoring and assessing financial solvency of the companies it regulates. Significant changes have been made in recent years in light of lessons learned from failures. However, during a period of significant work pressures, emphasis has been placed on implementing the changes as opposed to documenting fully the processes used. The Department believes that it has developed appropriate criteria for determining what constitutes a potentially risky company and that risk areas are being appropriately considered both in the planning and carrying out of examinations. However, the Department agrees that documentation of the processes followed should be improved and steps will be taken to see that this is done.

The Department recognizes that there are areas in the examination function where special expertise may be necessary. Some have already been identified and use has been and continues to be made of outside experts such as real estate appraisers and claims specialists. Efforts to identify known and potential risk areas where additional expertise may be required will be strengthened.

The Department has taken a number of important actions in response to anticipated industry trends and potential new areas of risk. However, it recognizes that more time could beneficially be spent on this area if more resources were available.

Co-ordination of Regulatory and External Audit Functions

12.24 We examined the process by which the Department co-ordinates its own regulatory functions, particularly the analysis and examination functions and how it co-ordinates its work with the external auditors of the regulated companies and with other regulatory bodies.

12.25 **Co-ordination between analysis and field examination functions.** The results of statement analyses should aid in determining the direction of the field examination.

12.26 Each division has assigned specific companies to specific analysts. Before and during examinations, the examiners are in contact with the analyst responsible for the company. This communication is both oral and written. Over the past two years, there has been an increase in the exchange of information between the analysts and examiners. However, there is room for further improvement in the co-ordination of these two functions.

12.27 This is partly due to the fact that guidelines and procedures are not fully documented and that staff are located in different cities. As a result, the staff in the two functions may not be fully aware of the extent of each other's surveillance activities in each company, and this sometimes leads to duplication of work. This is particularly true in ratio and loan analysis and financial statement review and calculation.

12.28 We believe there could be merit in the Department relocating its analysis function in closer proximity to the field examination function. Not only would this result in better co-ordination of the overall monitoring process, with possible economies in person-years, but it would place all individuals nearer to the headquarters of the companies they regulate and give them a greater awareness of the industry environment. It would also provide for faster resolution of matters arising from both the analytical reviews and field examinations.

12.29 **Co-ordination with external auditors.** Over the last two years, the Department has begun to establish closer contacts with the external auditors of regulated companies; the examiners meet with the auditors to discuss the scope of their examination and obtain copies of their reports. However, there is potential for placing even greater reliance on external audit work and better co-ordinating the extent of the field work.

12.30 We found that, although contacts were usually being made with the external auditors, the extent of reliance that had been placed on their work was generally not documented. In some instances, external auditors were contacted only after the examination was complete. Our review indicated that there was still considerable overlap between the work done by the examiners and that done by external auditors; for instance, security counts, re-performing bank and other reconciliations and checking the assembly of audited annual statements.

12.31 At the time of filing annual statements, external auditors are required to give an opinion only on the balance sheet, income statement and certain supporting exhibits which, in total, constitute about one-fifth of the total information filed. Requiring additional assurance from the auditors on some of the detailed financial schedules would assist the

Department in reducing its detailed review and analysis and the scope of the field examinations. This would allow the examiners to focus more attention on assessing the financial solvency of the companies concerned and the quality of their management practices.

12.32 Existing legislation gives the Superintendent the right to direct the external auditors of certain insurance and trust and loan companies to expand the scope of the annual examination or to have a special audit of the company conducted. The legislation also provides that such expenses are to be paid by the company. The Department has exercised this right only once. Doing so, particularly in those companies where it is conducting extensive surveillance and examination activities, would not only help prevent the redirection of examination staff from their regular examinations of other companies, with a resulting reduction in planned scope, and provide opportunities for increased co-ordination with external auditors, but would also result in the companies subjected to extensive surveillance absorbing part or all of these additional costs.

12.33 **To increase its efficiency, the Department of Insurance should:**

- **improve the co-ordination and integration of the work of the analysts and field examiners;**
- **consider relocating analysts to the regional offices;**
- **continue to improve co-ordination of field work with external auditors;**
- **place more reliance on the external auditors of regulated companies for the review and audit of historical financial information and redirect its field examinations to focus much more on risk areas; and**
- **consider exercising more frequently its legislative right to have special and expanded audits conducted by external auditors.**

Department's response: The Department agrees that co-ordination and integration of the work of the analysts and field examiners is extremely important. As a result of significant efforts made in recent years, the Department believes that the existing co-ordination and integration between the two functions is good and that any duplication of effort is not significant. However, the Department recognizes that the processes and responsibilities should be better documented to ensure that duplication is eliminated and that efforts should continue to improve the co-ordination and integration of the work of analysts and field examiners.

The Department will study whether the relocation of analysts to its regional offices would improve its efficiency and effectiveness.

The Department will continue to improve co-ordination of field work with external auditors and, in this connection, will review the areas where it may be possible to place more reliance on external auditors of regulated companies.

The Department will consider exercising more frequently its legislative right to have special and expanded audits conducted by external auditors. However, the Department believes that it is important to recognize that two of the most significant problem areas it has faced in recent years relate to possible overstatement of real estate values and understatement of claims reserves. The Department's approach has been to deal directly with experts in these fields. Frequent use has been made of real estate appraisers and claims reserves specialists. In a number of instances, company external auditors have not been supportive of the reserves that the Department believed to be necessary for real estate related investments.

Methodology and Work Tools

12.34 Standards and procedures for carrying out supervisory activities were informal in many areas and inadequate in some. Work tools were out-dated and inefficient. For instance:

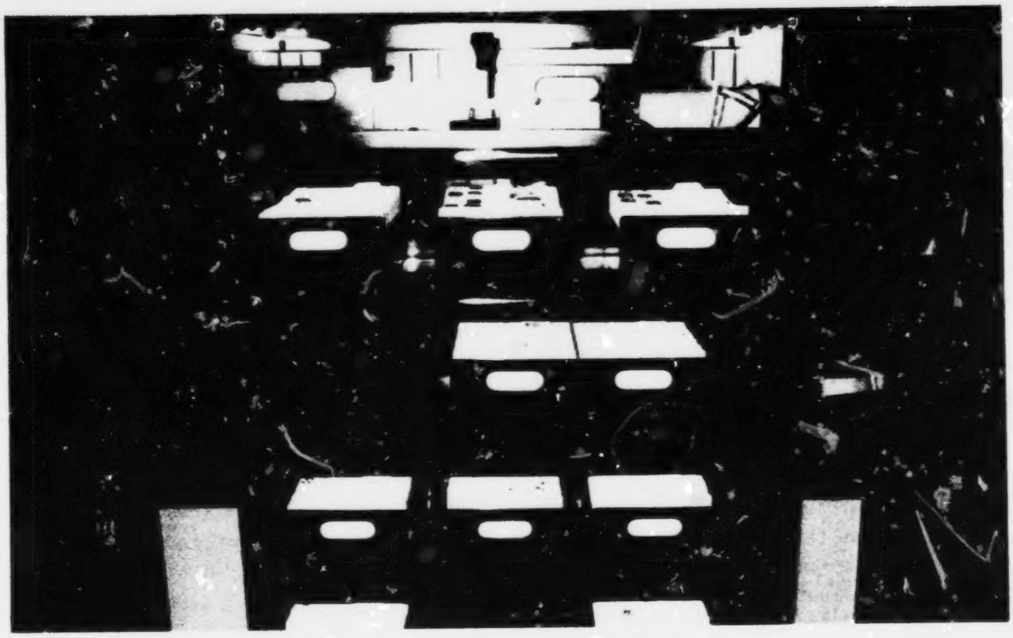
- Field examination standards, guidelines and procedures at the time of our audit required significant improvement. For instance, we found limited processes for resource allocation and budgeting, little evidence of planning and supervisory review, and poor documentation of work done. However, major initiatives were under way to complete policy and procedures manuals and to implement their use in the field examinations.

- Procedures for the review and analysis of statements were not fully documented.

- Limited use was being made of computer technology in many areas, with the result that opportunities for improved efficiency may be lost. For example, all analyses of company financial statements in the Trust and Loan Division were being done manually. In another instance, the records relating to over $17 billion in securities of British and foreign insurance companies deposited with the Receiver General for Canada were being maintained manually by the Special Services Division. During 1985, the Department processed 25,000 investment transactions and calculated in excess of 2,000 deposit positions.

- The current organization of the examination function that was introduced in the late-1960s is inefficient, leading to problems in directing, reviewing and reporting on the results of examinations and in developing and advancing staff. For instance, in the Toronto office, all examination staff, regardless of level, report direct to the Chief Examiners. This span of control is excessive given that each Chief Examiner is responsible for ensuring that upwards of 100 examinations are carried out each year. We were informed that classification difficulties have contributed to the problem.

12.35 The small size of the Department, the frequent communication between senior management and all levels of staff and the collective knowledge and experience of the employees have alleviated these problems to some extent. But, given the complexity and nature of the industries it regulates and the rapidly changing environment, the Department needs to question the usefulness of the techniques and procedures it was using 20 years ago.



The Department controls $17 billion in security deposits of foreign insurance companies using this manual card file system (see paragraph 12.34).

12.36 There are efforts now under way in various parts of the Department to introduce better guidelines and procedures, a major study to identify EDP needs has recently been completed, and the structure of the examination function is under review. However, these initiatives will need direction, co-ordination and support from senior management to ensure that they are implemented promptly.

> *Departmental comments**: Senior management recognizes that standards and procedures can continue to be improved. As indicated above, initiatives are under way and senior management intends to provide the direction, co-ordination and support necessary to ensure that they are implemented promptly.*
>
> *With respect to field examinations and review and analysis of statements, significant changes in the manner in which the Department carries out examinations and analysis work have been made in recent years. While the Department will continue its efforts to make further improvements, it believes that the quality of its examination and analysis work is satisfactory. However, again in a period of severe work pressures, emphasis has been placed on implementing the changes as opposed to documenting fully the processes used. The Department agrees that documentation of standards, guidelines and procedures needs to be improved and steps will be taken to see that this is done.*

Liquidation of Companies

12.37 Under the provisions of the Canadian and British Insurance Companies Act, the Foreign Insurance Companies Act, the Trust Companies Act and the Loan

Companies.Act, the Superintendent of Insurance must report to the Minister of Finance when he believes the assets of a company are not sufficient to protect the policy holders, depositors, debentureholders and other creditors of the company. The Minister can initiate procedures for winding up a Canadian company or a foreign company's operations in Canada. For Canadian companies, the Superintendent can take control of the company's assets on his own or as directed by the Minister.

12.38 At the time of our audit, the Superintendent was in the process of liquidating four Canadian, and the Canadian branches of two foreign, property and casualty insurance companies (see Exhibit 12.3). In each case, a national receivership firm had been appointed as the Superintendent's agent to carry out the liquidation under his direction. Total costs of liquidating these companies, comprising agent and legal fees and administrative expenses, are estimated to exceed $70 million. These costs are being recovered from the insurance industry. As of 31 March 1986, they amounted to some $17 million, of which $7 million was incurred during 1985-86.

12.39 The Department's guidelines for appointing agents require the submission of three to five proposals, and there are detailed selection criteria that include the experience of the agent's personnel, fee rates and industry concurrence. Since 1982, the Department has entered into formal contracts with agents that stipulate reporting responsibilities, staffing and rates for the agent and for the legal services to be provided during the liquidation. The agents are required to submit work plans, budgets and quarterly status reports. The departmental officer responsible for the process maintains frequent contact with the agents and with the Industry Advisory Committee throughout the liquidation period.

12.40 We have concluded that the present process for handling insurance company liquidations is generally satisfactory.

Supervision of Pension Plans

12.41 The Department of Insurance is responsible for administering the Pension Benefits Standards Act (PBSA) which regulates all federally registered employee pension plans, except for the federal government's public service pension plans. In essence, the Department is responsible for ensuring the financial solvency of these plans and making sure that requirements for legislative funding, investment and plan provisions are met.

12.42 The Department supervises some 750 plans covering 600,000 employees. These plans, with total assets of about $28 billion, range from very small ones with fewer than 10 members to plans with over 10,000 members. The types of employers range from sole proprietors and Indian bands to chartered banks and multinational corporations.

12.43 The Pension Benefits Division, under the direction of the Chief Actuary, is responsible for administering the Act. The Division provides actuarial advice to the Department of National Revenue - Taxation regarding the deductibility of certain employer contributions. It also supervises certain provincially registered pension plans under the terms of federal-provincial reciprocal agreements.

Exhibit 12.3

INSURANCE COMPANIES IN LIQUIDATION AT 30 JUNE 1986

Company	Liquidation Date	Liabilities at Liquidation ($ millions)	Liquidation Cost ($ millions) to 31 March 1986	Liquidation Cost ($ millions) Total Projected
Pitts Insurance Company	1981	20.0	6.5	7.8
Cardinal Insurance Company	1982	12.0	4.2	6.2
Ideal Mutual Insurance Company	1985	3.5	.1	.5
Northumberland General Insurance Company	1985	170.0	5.5	45.4
United Canada Insurance Company	1986	20.0	.3	12.0
Midland Insurance Company	1986	.6	-	.5
		$226.1	$16.6	$72.4

Source: Department records

Pension Reform

12.44 The Department has been heavily involved in pension reform over the past several years. The Pension Benefits Division, in particular, has been involved in drafting Bill C-90, which made amendments to the PBSA, and in drafting extensive changes to the regulations. The division director estimates that he spends about half his time on pension reform issues, including discussions with other pension authorities on implementing uniform pension legislation across the country.

12.45 The new legislation will result in an additional workload for the Department. For the sort of major changes that are contemplated, one would expect to see an implementation plan that would include forecasts of workload requirements and staffing and training needs, estimated turnaround times for processing applications and annual renewals, and deadlines for making revisions to procedures manuals. We saw little evidence that any of this was being done. Without such a plan, the Department may not be in a position to cope in an efficient and effective way with the new workload.

12.46 The Department of Insurance should develop plans to deal with changes in the Pension Benefits Standards Act so that it can cope with the increased workload for the Department.

Department's response: *The Department agrees that plans should be developed to deal with the recent major revision of the Pension Benefits Standards Act. Some plans have already been developed and others are in the process of being developed.*

Registration

12.47 The Pension Benefits Standards Act sets out standards for registering employee pension plans that come under federal jurisdiction.

12.48 In our opinion, registration procedures are satisfactory. We found that the individuals involved in the registration process whom we interviewed were knowledgeable about the legislation and the plans they administer. The turnaround time for processing applications and renewals, reviewing actuarial calculations and dealing with queries is less than two weeks, and complaints are rarely received from plan sponsors.

Assessing Financial Solvency

12.49 The number of pension plans administered by the Division is growing rapidly. In the last calendar year, some 150 new plans were registered, bringing the total to over 750; during the same period, the total assets administered by the plans grew from $22 billion to $28 billion.

12.50 The Department has the same stated objective for monitoring pension plans as it has for supervising financial institutions – to ensure their financial solvency and the propriety of the organizations' management policies. However, the way in which the Department supervises pension plans is much less rigorous than it is for insurance and trust and loan companies. In the case of pension plans, the Department relies almost entirely on the representations of management. It carries out few field examinations and the only audited information required is an audited statement of assets every three years for non-insured pension plans.

12.51 The Department believes that pension plans are not exposed to the same risks as the financial institutions. For instance, only one plan has been wound up in a deficit position since the legislation (PBSA) was enacted 18 years ago. Problems from wind-ups are minimized because actuaries use conservative estimates in determining funding requirements. In addition, pension fund assets are often administered under trustee arrangements with financial institutions.

12.52 Still, we have seen no evidence of any formal process for assessing risk and vulnerability that indicates whether present supervisory practices are adequate. For example, we would have expected to see some evidence of consideration of those factors, such as self-dealing activities and changes in real estate values, that contributed to the recent insolvencies of financial institutions. Over the past several years, there have been a number of major wind-ups and mergers. There is a growing trend to withdraw surpluses from pension funds to provide cash funds for company operations.

12.53 In our opinion, the Pension Benefits Division is running the risk that its present supervisory procedures will not permit it to do an adequate job of monitoring the financial solvency of employee pension plans and the propriety of the employers' management policies. There are satisfactory procedures for monitoring compliance with legislative requirements, registering plans and reviewing actuarial reports. But the Division does little to obtain independent assurance; for instance that employee contributions have been paid into the fund, and that the company applies appropriate management practices in administering the plan for the benefit of its members.

12.54 Since the first field examination was carried out in 1971, there have been only 42 examinations of the some 750 plans; no plan has been audited more than once. On average, only three or four examinations have been done each year.

12.55 In selecting plans for examination, the Division tries to aim at large plans and those with suspected problems. Other than that, there are no guidelines for selection, no criteria for determining audit scope, limited examination procedures and no guidelines for reporting and following up observations. Recent examinations have been conducted by only two or three people, and the on-site visits have lasted only three or four days, irrespective of the size of the plan.

12.56 Procedures for reviewing pension plan assets are inadequate. Under the terms of the current legislation, pension plan sponsors are required to submit triennial statements of assets to the Department. These are reviewed to ensure that the assets meet the eligibility criteria specified in the Act. However, there are no written procedures to ensure the cross-checking of the statements against audited financial information to make sure they match. Nor are independent reviews carried out by the Department through field examinations or otherwise, to assess the underlying value of investments in real estate, mortgages and other such assets. Moreover, the present statement of assets does not provide any information on asset activity between the reporting dates, so there is no way to find out whether ineligible investments were made during the intervening period.

12.57 **The Department of Insurance should undertake a thorough review of its present supervisory practices for pension plans. In particular, it should:**

- **carry out a formal risk assessment and identify priority areas;**
- **assess the adequacy of its present field examination standards;**
- **review the adequacy of procedures for monitoring pension plan assets; and**
- **evaluate whether the Department's present procedures clearly reflect its duties and responsibilities under the Act.**

Department's response: In monitoring financial solvency, the Department and the corresponding supervisory agencies in the provinces having pension legislation have traditionally relied principally on the information provided in the annual information return, the triennial actuarial valuation required to be *prepared by a qualified actuary, and the triennial audit of assets. It has been the Department's practice to conduct a few examinations every year, concentrating on plans where supervisory problems have been encountered.*

Actuarial valuations are scrutinized particularly carefully to ensure that the Department is satisfied that the actuarial assumptions and methods are adequate and appropriate and are in accordance with Recommendations for the Valuation of Pension Plans established by the Canadian Institute of Actuaries (CIA). In the Department's opinion, current market values of assets are not as crucial to the solvency of pension plans as they are to financial institutions with demand or short term liabilities. In accordance with the CIA Recommendations for the Valuation of Pension Plans, the asset valuation method used by the actuary must be consistent with the economic assumptions used for the calculation of the related value of benefits and compliance with this requirement is carefully monitored.

The Pension Benefits Standards Act 1985, which received Royal Assent on June 27, 1986 and becomes effective January 1, 1987, together with the pertinent Regulations which have been released in draft form for discussion purposes, include a number of measures to try to further ensure financial solvency of pension plans. Pension plan administrators will have a statutory obligation to administer the pension fund to protect the benefits of plan members. All amounts deducted by an employer from members' remuneration that have not been remitted to the pension fund, as well as any amounts due from the employer, will be deemed to be held in trust and the plan administrator will be obliged in accordance with the Regulations to advise the Superintendent if any remittances of pension fund contributions are overdue more than 60 days. Information on plan assets can be required to be filed as frequently as the Superintendent of Insurance directs and audited financial statements, as opposed to the current audited lists of assets, will be required.

Notwithstanding the above comments, the Department recognizes the desirability of carrying out periodic reviews of its supervisory practices. Therefore, it intends to carry out the review, assessments, and evaluation recommended.

Reviews by Other Pension Bodies

12.58 Legislation provides for the federal government to enter into reciprocal pension arrangements with the provinces; it has done so with seven. The purpose of these agreements is to eliminate duplication of administrative procedures in supervising pension plans that are subject to the PBSA and also to one or more similar provincial acts. During 1984-85, 94 plans covering 146,000 employees were supervised by the provincial authorities on behalf of the Department of Insurance, and 25 provincially-registered plans covering 24,000 individuals were supervised by the Department.

12.59 The industry generally acknowledges that guidelines for monitoring compliance with legislative requirements are much stricter at the federal level. We noted that although the Department does receive a certificate of supervision from provincial authorities, it has no written guidelines for the provinces to follow in supervising pension plans on its behalf nor does it formally review the work they do in this connection. In view of the significant number of plans supervised outside the Department, it is important that formal arrangements be in place. Without such guidelines, the Department has no way of ensuring that the pension plans are well supervised.

12.60 Where pension plans are supervised by provincial authorities on behalf of the Department, or vice versa, the Department of Insurance should establish standards and guidelines to ensure that all pension plans receive an adequate and consistent level of supervision.

> *Department's response: The Department will raise this matter at the next meeting of the Canadian Pension Supervisory Authorities which has as its principal objective the uniformity among jurisdictions of pension legislation and regulation. Provincial authorities supervising pension plans on behalf of the Department will be provided with copies of pertinent procedures manuals and other work instruments. It is agreed that all pension plans falling within the jurisdiction of the Department should receive an adequate and consistent level of supervision.*

Actuarial Services

12.61 Under the direction of the Chief Actuary, the Actuarial Branch provides actuarial services and advice to the federal government on a vast array of government programs. The bulk of these services relate to preparing actuarial calculations and statutory reports on the Canada Pension Plan and the government's employee pension plans.

12.62 The results of this actuarial work are significant in many pension policy deliberations. For example, projections of long-term cost commitments can have an effect on determining the level of contribution rates, determining pay scales and assessing the ongoing costs of social programs. Each year, actuarial projections of unfunded liabilities are reflected in the Public Accounts of Canada.

12.63 The enactment in March 1986 of Bill C-255 on Public Pension Reporting requires the Chief Actuary to conduct actuarial valuations of all government employee pension plans, including those for Judges and Members of Parliament, at least every three years. Reports must be tabled in Parliament within 18 months of the review date. Previously, although the Chief Actuary traditionally carried out these reviews, he was not designated by law to do all of them; moreover, not all actuarial reports were required to be tabled in Parliament, and there was no reporting deadline for any of them.

12.64 The legislation requires more frequent reporting in respect of the Canada Pension Plan. In addition, long-term cost projections for the Old Age Security program, which have never been carried out before, have to be calculated by the Chief Actuary and are subject to the same requirements as the pension programs.

Valuation Process

12.65 We reviewed the methodology used in the valuation of the largest employee pension plan, the Public Service Superannuation Account (31 December 1980). We also took into account the results of our review of the 8th Statutory Report of the Canada Pension Plan (31 December 1982), carried out as part of our 1985 audit of public pension management.

12.66 The results of both these reviews indicated work of a quality that meets high professional standards. The actuarial assumptions used were, on the whole, consistent and reasonable. The Chief Actuary is involved in setting all actuarial assumptions and in writing the final reports. In addition, the reports are comprehensive – for example, certain of the actuarial assumptions vary not only by the employee's age but also by length of service, periods since retirement, periods since widowhood, etc. Moreover, this degree of thoroughness has not suffered in spite of the constant demand for urgent and special work placed on the divisions.

Timeliness of Information

12.67 The dollar magnitude of federal retirement income programs (in excess of $20 billion in annual expenditures), together with their high visibility and significant impact on government expenditures, makes it important that actuarial projections of long-term costs and commitments of the programs are available when they can be used to best advantage. Moreover, not having current and timely information can result in incorrect information on actuarial surpluses or deficiencies. The enactment of Bill C-255 on Public Pension Reporting now makes timely reporting mandatory, requiring that actuarial reports be tabled no later than 18 months after the review date.

12.68 So far, the Actuarial Branch has been able to provide information on the Canada Pension Plan on time, despite the additional workload requirements. The most recent statutory report was tabled in Parliament 17 months after the valuation date. Time pressures created by special assignments during the same period have been dealt with by using rough estimates when precise numbers were not necessary. The Department believes that there will be adequate time to deal with the additional requirements for the valuation of the Old Age Security program and that the reporting deadlines will be met.

12.69 There is a problem with providing actuarial reports on employee pension plans on time, however. Exhibit 12.4 shows the significant delays in tabling information in Parliament. The principal reasons for this have been the demands on the Branch for other top-priority work, delays in defining requirements for and receiving data from the Department of Supply and Services (DSS), and delays by Ministers in tabling completed reports.

12.70 There are significant time pressures created by the constant stream of urgent work imposed by Cabinet, the Treasury Board and other government departments and agencies. These special priority assignments take up a considerable portion of available hours. Based on the Branch's time records of the Division responsible for working on employee pension plans, it is estimated that 25 to 35 per cent of its efforts were devoted to special projects from 1982 to 1985. In the second half of 1985, approximately 90 per cent of available time was spent on these types of assignments, causing even longer delays in performing normal work.

12.71 In the face of such interruptions, the actuarial staff have been forced to decide between performing a less professional job on the actuarial reports on public service pension plans and extending deadlines. They have generally chosen to extend deadlines.

12.72 To do the actuarial reports on public service pension plans, the Division requires computer data from the departments that administer the payroll systems. The Department of Supply and Services provides a significant part of the data.

12.73 For many years, there have been lengthy delays in finalizing this data. On average, it has taken 15 to 30 months after the review date to do this. In some instances, there have been delays (in one case, it was 14 months) by the Department of Insurance in providing DSS with final specifications for data requirements. In other instances, it has taken DSS up to a year, after the receipt of final specifications, to provide the raw data.

12.74 Moreover, the Division has had considerable difficulty reconciling the number of plan members from valuation to valuation. An example of this problem appears in the last completed valuation, as of 31 December 1980, of the Public Service Superannuation Account where there was a significant unidentified actuarial loss of $398 million that appeared to relate primarily to errors in the membership data.

12.75 The DSS data systems are being amended. To date, the Department of Insurance has not been consulted on the proposed changes. Moreover, we noted that there is no formal memorandum of understanding between the Departments as to the timing, kind and quality of the information required.

12.76 In our opinion, the Department needs to take aggressive action to deal with this situation.

12.77 To meet the new legislative reporting requirements, the Department of Insurance should:

- **consider alternative ways of meeting workload requirements, such as contracting work out, when special priority assignments are imposed on the Chief Actuary that are likely to lead to lengthy delays in producing ongoing actuarial reports; and**
- **take immediate action, together with the Department of Supply and Services, to resolve the long-standing problem of late and inaccurate employee pension information and to reduce the likelihood of future occurrences.**

Exhibit 12.4

DELAYS IN TABLING ACTUARIAL REPORTS ON GOVERNMENT EMPLOYEE PENSION PLANS STATUS AT 30 JUNE 1986

Plan	Reporting Period Ended December 31*	Department Received Data	Report Completed by Chief Actuary	Report Tabled by Minister
Regular Forces death benefit	1975	Information not available	Jan. 1980	Jan. 1981
Public Service Superannuation	1980	Jul. 1982 to Feb. 1983	Apr. 1984	Oct. 1985
Public Service death benefit	1980	Jul. 1982 to Jul. 1983	Dec. 1984	Oct. 1985
Canadian Forces Superannuation	1980	Jan. 1982 to Mar. 1983	Dec. 1985	Apr. 1986
Royal Canadian Mounted Police Superannuation	1982	Jun. 1983 to Jun. 1984	Mar. 1986	Jun. 1986

*Most current review completed.

Source: Department records

Department's response: The Department will consider alternative ways of meeting workload requirements such as contracting work out.

With regard to the problem of data and inaccurate employee pension information, the Department will make every effort to ensure that, in accordance with its long standing policy, data specifications are provided well in advance of the end of any reporting period and stands ready to provide whatever assistance is required by the Department of Supply and Services to resolve any remaining problems.

Methodology and Work Tools

12.78 We also reviewed the processes and guidelines in place to carry out and review the valuations. In our opinion, the work processes and review procedures were generally satisfactory.

Reporting to Parliament

12.79 The Department of Insurance reports annually to Parliament on the administration of the legislation governing the financial institutions and pension plans it is responsible for regulating. The Department is also required to table periodic actuarial valuations of government pension plans. Finally, through the Estimates, it accounts to Parliament for its financial performance.

12.80 **Estimates.** We reviewed Part III of the Department's 1986-87 Estimates for adequacy of content and accuracy of disclosure to Parliament. In our opinion, the information contained in the Estimates generally meets the standards of disclosure developed by the Office of the Comptroller General.

12.81 **Annual reports.** Complying with legislation, the Department prepares annual reports containing information on the financial condition and affairs of supervised financial institutions. Through a computer data bank, it also makes information available to the public from annual financial statements filed by these companies.

12.82 Over the past six years, the Department has taken action to reduce the volume of data in the reports, computerized the process of assembling the financial information and advanced the tabling date. Current plans call for an even earlier completion of this year's annual reports.

12.83 Despite these efforts, the reports are still voluminous. The 1984 annual report on Life Insurance Companies and Fraternal Benefit Societies ran to over 400 pages. Most of these pages are devoted to summary financial information on each company. Although the legislation requires the reporting of this information to the Minister, and subsequently to Parliament, this kind of detailed reporting may no longer be appropriate.

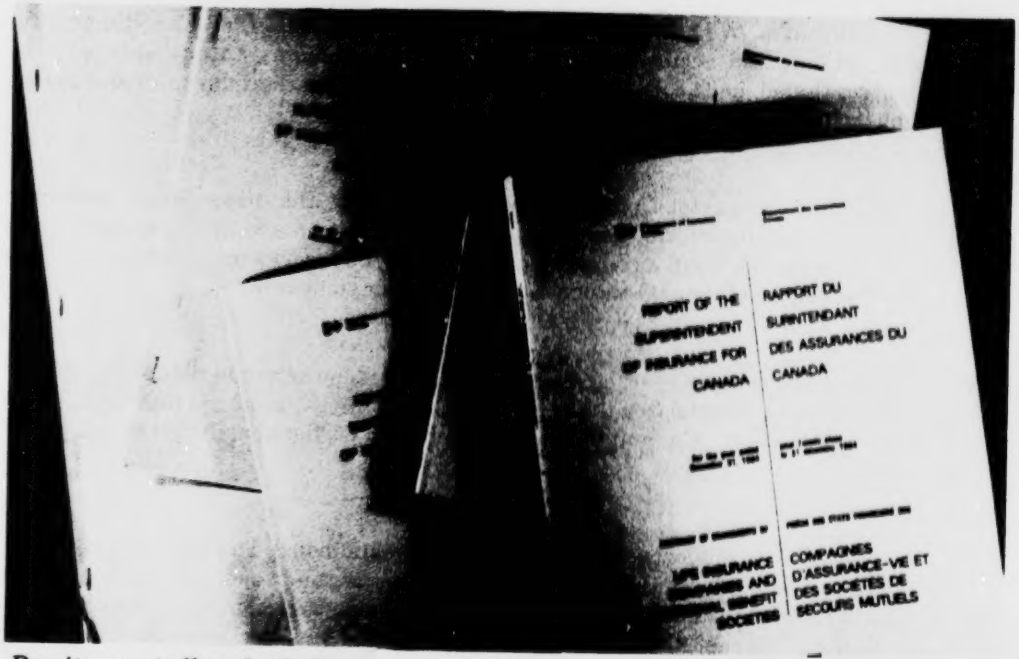
12.84 Much of the same information is usually available to the public about six months before the printed information is tabled in Parliament in the computer data bank referred to earlier.

12.85 On the one hand, information about financial institutions is extensive; on the other, information in the annual report on administering pension plans is very limited. The value of both kinds of reports is questionable.

12.86 **The Department of Insurance should assess how useful the present annual reports are to Members of Parliament and consider alternative, more effective ways of providing the information.**

> *Department's response: The Department agrees that it would be desirable to carry out another assessment of the usefulness of the present annual reports not only to Members of Parliament but also to members of the public and to the industries concerned who ultimately pay the related costs. Appropriate steps will be taken.*

12.87 **Actuarial reports.** The Public Pension Reporting Act (Bill C-255) will require tabling actuarial reports in Parliament on all major federal pension plans. The purpose of the legislation is to improve the reporting and timeliness of information to Members of Parliament about pension costs.



REPORT OF THE
SUPERINTENDENT
OF INSURANCE FOR
CANADA

RAPPORT DU
SURINTENDANT
DES ASSURANCES DU
CANADA

LIFE INSURANCE
COMPANIES AND
FRATERNAL BENEFIT
SOCIETIES

COMPAGNIES
D'ASSURANCE-VIE ET
DES SOCIETES DE
SECOURS MUTUELS

Despite recent efforts by the Department to reduce the size of its five annual reports, one still runs to over 400 pages (see paragraph 12.83).

12.88 As they are now drafted, the actuarial reports are written in such a manner that they are clearly understood by members of the actuarial profession. But, generally, persons other than those with actuarial knowledge have difficulties understanding the financial implications of what is being said. In view of the significance of the cost projections contained in these reports and the policy implications involved, there is a need for the Department to consider presenting summary information in a way that clearly sets out for Members of Parliament and other readers the implications of what is being reported. Using charts and graphs would be helpful in this regard.

12.89 **The Department of Insurance should make it easier for Members of Parliament and other readers to understand the implications of the information contained in its actuarial reports.**

> *Department's response: The Department will continue in its attempts to make it easier for Members of Parliament and other readers to understand the implications of the information contained in its actuarial reports.*

Planning and Evaluation

Planning

12.90 Given the Department's important role in regulating Canadian financial institutions and protecting the public against financial loss, strategic planning is essential for the effective management of its operations. It is important that the Department be able to consider future risks and anticipate industry trends, conditions and requirements and to develop strategies and plans for dealing with them. A strategic overview was prepared in March 1980. The Department was exempted by Treasury Board from having to produce a subsequent overview and, as a result, it has not been updated since then.

12.91 The Department's formal planning processes are limited. There is a Director of Legislative Planning who is responsible for preparing new legislation. The Superintendent is a member of a Senior Advisory Committee that is currently looking at the reorganization of the federal regulatory bodies involved in supervising financial institutions. The small size of the Department and the close and continuous contact between the Superintendent and the senior staff contribute to the planning process, but in an informal way.

12.92 Departmental officials acknowledge the need for better planning. They believe that the many outside pressures over the last few years – company failures, pension reform and pending major changes in existing legislation – have prevented them from devoting enough time to this area. For instance, dealing with each company failure over the past several years has taken as much as 50 to 100 per cent of the time of the Superintendent and the directors of the affected industry divisions for periods of up to several months.

12.93 In our opinion, a better strategic planning process, suited to the Department's needs and incorporating the results of evaluation studies, would help them to anticipate and cope with some of these pressures.

12.94 In addition, the use of performance measurement and other techniques and integration of human resource planning would do much to improve the usefulness of the existing plans.

12.95 **The Department of Insurance should improve its existing planning processes by:**

- **preparing and regularly updating a strategic plan;**
- **integrating human resource planning with operational planning; and**
- **making better use of performance measurement and other planning techniques.**

Department's response: *The Department acknowledges that existing planning processes should be improved. A strategic plan will be prepared and further steps will be taken to integrate human resources planning with operational planning. Some work has been done on performance measurement but some outside assistance may be necessary to complete this endeavour.*

Program Evaluation

12.96 The Department has not completed an evaluation of any of its activities.

12.97 In January 1984, the Department developed a plan to evaluate its Supervision of Companies activity. The first part of the study, which was a series of case studies of institutions experiencing financial difficulties, was completed in June 1985. The remaining parts of the evaluation, dealing with an internal review of its supervisory methods and procedures and comparisons with other jurisdictions, have been deferred until resources become available.

12.98 In June 1985, the Department revised its plan relating to the Supervision of Companies activity and developed a plan to cover its other activities. Because of the number of companies continuing to experience financial difficulties, the officer responsible for conducting the study was assigned to duties considered to be more pressing, and he was not replaced.

12.99 The revised evaluation plan has never been formally approved by senior management.

12.100 No evaluation studies or assessments have been yet undertaken of the Department's other major activities, Supervision of Pension Plans and Actuarial Services, although the draft evaluation plan provided for completion of a review of these activities by 1988 and 1987 respectively.

12.101 Despite the delays in carrying out the evaluation studies and the present lack of resources devoted to this function, senior management seems to be committed to the importance of this activity. The Superintendent has said he intends to fill the position of the previous incumbent. He is also considering the possibility of using outside resources to conduct the evaluations.

12.102 **The Department of Insurance should approve and implement its evaluation plan and ensure regular evaluations of the effectiveness of all departmental programs.**

> *Department's response: Through re-allocation of internal resources, a position at a senior officer level has been established to assume responsibility for the implementation of an evaluation plan. Staffing of the position is in progress.*

Cost Recovery

12.103 Total program expenses incurred by the Department amounted to $19 million in 1985-86. In accordance with legislation, expenditures incurred by the Department for the supervision of financial institutions are recovered from the institutions. Also, costs of rehabilitating and liquidating companies are fully recovered from the industry. The cost of work done on behalf of the Canada Deposit Insurance Corporation (CDIC) and the provinces, as well as for the Canada Pension Plan, are recovered from those organizations, too. Fees paid by pension plans supervised under the PBSA cover 70 per cent of departmental administration costs. So the Department recovers 85 per cent of its regular expenses and 100 per cent of liquidation and rehabilitation costs.

12.104 Supervision and liquidation costs are billed after the end of the fiscal year. Actuarial services and work done on behalf of CDIC are billed quarterly, based on estimated costs, with a final adjustment to actual. Pension plan fees are remitted at the time of filing annual returns.

12.105 In our opinion, the cost identification and allocation process is accurate and conforms with the legislation and the agreements entered into with the provinces and other agencies. There have been a number of recent management initiatives to improve cost-recovery procedures, but we believe that further improvements would result in savings to the federal government.

12.106 Traditionally, it has been the practice of the Department to bill supervision and liquidation costs to the industry only after the close of the fiscal year. This can take up to eight months after the year end.

12.107 The present practice results in loss of interest to the Consolidated Revenue Fund. Using Government Treasury Bill rates (average 90 day rates), we estimate that by not billing regular supervision and special assessment (liquidation) costs as incurred, there was a loss in foregone interest to the federal government of over $1 million in each of the last two fiscal years.

12.108 The Department should consider billing these costs as incurred. This probably will require a change in legislation.

12.109 **The Department of Insurance should adopt the practice of billing all recoverable costs as they are incurred.**

> Department's response: *The Department of Justice has confirmed that an amendment to the Department of Insurance Act will be necessary to authorize the billing of regular supervision and special assessment costs on a basis more frequent than annual and this will be kept in mind as work on the revision of legislation related to the supervision of financial institutions proceeds. In the meantime, procedures for preparing the assessments have been revised and the eight month period referred to in the report has been reduced to four.*

THE VETERANS AFFAIRS PORTFOLIO

THE VETERANS AFFAIRS PORTFOLIO

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The Department's stated mission is "to manage special programs for veterans and other specified persons, which will compensate for death or disabilities incurred in the service of Canada, or enable them to be self-sufficient and participative members of the community, or to fulfil their functional and social needs, and to otherwise perpetuate recognition of wartime sacrifice and achievements, and their contribution to Canada."

13

THE VETERANS AFFAIRS PORTFOLIO

Introduction

13.1 In our 1980 Report, we reported the findings from the first comprehensive audit of the Veterans Affairs Portfolio. In this audit we looked at many of the same areas and issues that were reported in 1980. However, we did not re-examine every issue raised in the earlier report, nor did we restrict our scope to the areas looked at then. Using the 1980 chapter as a guide, along with the substantial knowledge of the Department and its operations gleaned from our annual Public Accounts audit work, we carried out a new survey of the Portfolio to identify the issues and areas that are salient to the Portfolio and to Parliament in 1986. We found much that had changed and much that had stayed the same.

The Environment in which the Portfolio Operates

13.2 The Veterans Affairs Portfolio consists of the Department of Veterans Affairs and four independent agencies – the Canadian Pension Commission, the Pension Review Board, the War Veterans Allowance Board, and the Bureau of Pension Advocates – all reporting to or through the same Minister. Together, according to the 1986-87 Estimates, they will account for a total expenditure of $1.6 billion, the eleventh largest in expenditures among departments. They operate in support of the three major programs of the Portfolio: the War Veterans Allowance, Health and Social Services, and the Canadian Pension Commission. The War Veterans Allowance program will provide allowances worth over $431 million to approximately 84,000 eligible persons in 1986-87. The Health and Social Services program expects to spend $301 million on the provision of health care and related services, including the Veterans Independence Program ($21 million). The Canadian Pension Commission Program involves the delivery of $788 million in disability pensions to 140,000 eligible persons. Combined, these three programs account for nearly 90 per cent of the Portfolio's total expenditures.

13.3 **The move to Charlottetown.** At the time of our last audit, the Portfolio was entering the most active stage of a move that would see the Department's entire administrative apparatus and the staffs of the four agencies move from Ottawa to Charlottetown. Approximately 900 positions moved to Prince Edward Island, leaving only a small departmental headquarters complement, including the Deputy Minister and his office, and the Assistant Deputy Minister, Field Operations, in Ottawa to provide daily support to the Minister. The Department estimates that the move was accomplished at a cost of $28 million in 1979 dollars and required 720 person-years. The structure of the Department's accounts is such that we could not audit these numbers. The 1979 plan called for a cost of $24 million and 702 person-years.

13.4 In addition to the effects on operations, the move brought its own problems with it, not the least of which is the widely held view that the move has and continues to have adverse effects. Additionally, like all stresses, it exacerbated to some extent the effects of problems that already existed.

13.5 One of the key examples of the latter is the effect that the loss of corporate memory had on many areas of Portfolio operations. Fewer than 15 per cent of the people on staff made the move to Charlottetown, and few of these stayed in their old functions. Corporate memory was lost at virtually all levels and in nearly all functions. Further, the Department was not well equipped with systems and documentation. Before the move it had had a relatively stable labour force; staff carried much of the essential operational know-how around in their heads and took it with them when they left.

13.6 We found many examples, large and small, of the effects of this type of problem. One of the most notable arose when, shortly after the implementation of the Canadian Pension Commission Benefit Delivery System, the Commission and its related service groups in the Department of Veterans Affairs moved to Prince Edward Island. The system development staff did not relocate and dispersed to other jobs. They left a new and "undebugged" system with few instructions on its use and little documentation. The system has never performed up to its potential, and the repeated failures of the system have contributed to the problems encountered by the whole pension process. We discuss this more fully in Exhibit 13.8.

13.7 We found that, in addition to tangible problems, there is a pervasive view that the move and related events have created a situation of extreme organizational instability to the point that they have reduced the ability of staff, individually and collectively, to adapt to further adjustments. The Department offers this as an explanation of why some recognized improvements have either not been acted on or have been postponed. Nearly every manager we spoke to has raised this with us, usually during the first meeting and without prompting.

13.8 The need to encourage a stable and experienced work force in Charlottetown led to a commitment to provide a guarantee, to anyone relocating from outside the Atlantic region, of at least two years employment in their place of origin provided they stayed in Charlottetown for at least two years. The return option must be exercised within five years of relocation. We found that, although the program had influenced some employees to move to Charlottetown, many of them are requesting a return as the end of the five years approaches simply to protect their options.

13.9 **Other operational changes.** In addition to the move, several other events have contributed to the sense of instability in the Portfolio. The Disability Pension Process has been the subject of an independent Commission of Inquiry and an internal task force reporting direct to the Minister. For over a year, there has been intense pressure from the Minister to produce significant reductions in processing times. This was achieved, but at the cost of diverting energy and attention from the resolution of other administrative problems. Management's view was that these largely internal matters were less pressing than the need to improve the services to veterans.

13.10 The Nielsen Task Force recommended that all Portfolio services in an area be consolidated into a single location to provide "one-stop shopping." This meant that separate district field offices for different programs, sometimes in different locations, were to be consolidated into a single location in each district. Additionally, there was a major restructuring that has changed the responsibilities of one Assistant Deputy Minister position, created a new Assistant Deputy Minister position, and deleted another (see Exhibit 13.1). The Minister has announced a full scale legislative review to co-ordinate and simplify the 27 Acts that the Portfolio administers. These have added up to an environment in which management at all levels regards its first task as the achievement of stability.

13.11 Within the past two years the Department has seen the installation of an entirely new executive-level management team: a new Deputy Minister, and replacement of all the Assistant Deputy Ministers. While the Deputy and one of the Assistant Deputies are new to the Department, the fact that the three other Assistant Deputy Ministers have had extensive experience in the Department ensures that the new team has been put in place with a minimum of corporate memory loss at that level. At the time of our audit, this new team had begun a number of initiatives to deal with the many problems facing the Portfolio. However, most of these had not reached the stage where we could audit them.

13.12 Additionally, with the exception of the War Veterans Allowance Board, all the agency heads have changed in the last two years.

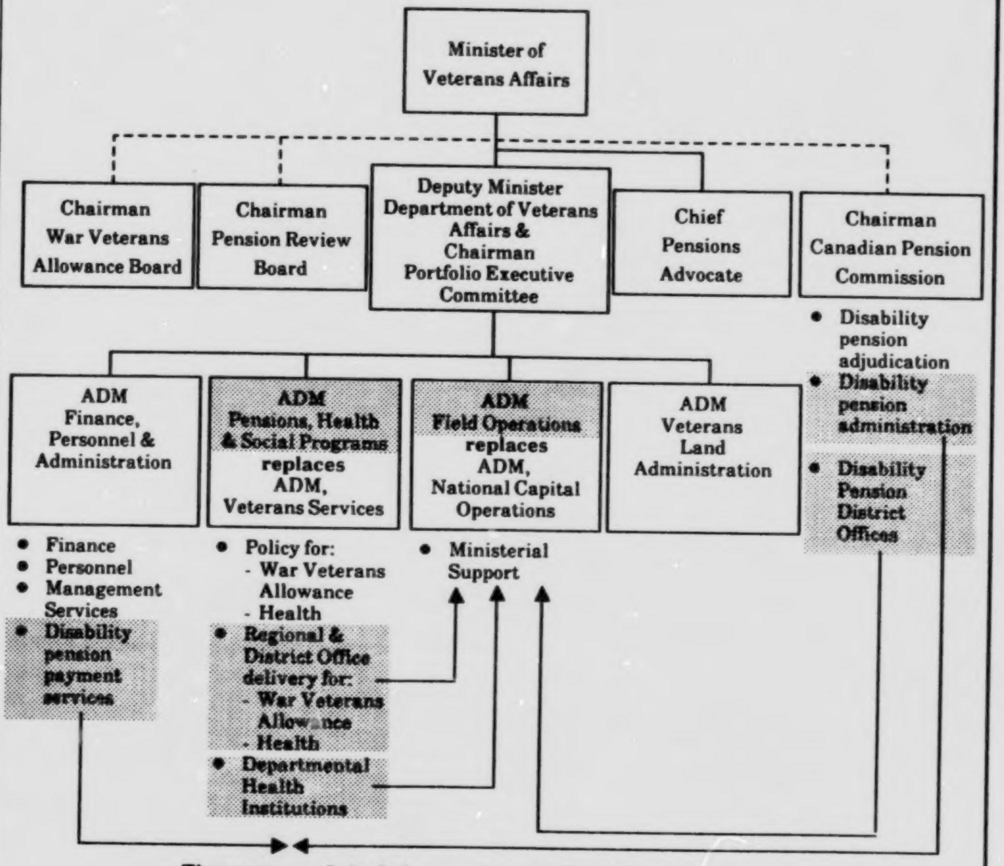
13.13 **The aging veteran population.** Another important factor in the Portfolio's environment is the aging of its client population. There are no comprehensive administrative data on the number of veterans or on the number that are or could be eligible for the Department's programs. The best available data are based on extrapolations from the results of information gathered in the 1971 Census, using a definition of "veteran" that is much less restrictive than the Department's. These estimates suggest that there are now about 650,000 surviving veterans. It is estimated that about half of these have the theatre-of-war experience that is a basic criterion for access to most of the Department's programs. Because this is a closed population, it is possible to predict the size and future age composition of these "census veterans" with reasonable certainty.

13.14 Exhibit 13.2 shows the Department's predicted size and age composition for this population in the years 1986, 1991, 1996, and 2001. There is a rapidly accelerating decline in the size of the population, particularly toward the end of the century. This suggests that the major challenges facing the Department must be met in the next 15 years. The distributions also show that in the next 15 years the changing age structure will place new demands on each of the Portfolio's three main programs. The demand for each will follow a pattern of initially slow growth, a rapid rise to a peak, and a drop to very little.

13.15 For the War Veterans Allowance program, where at age 65 the payments drop from the $500 to $1,000 a month range to less than $100 a month as a top up to the Old Age Security/Guaranteed Income Supplement, the peak has already passed. By the end of 1986 over 50 per cent of the population will have passed age 65. By 1991, this will be the case for over 85 per cent of the population. With a median age of over 70 in 1991, the period from 1991 to 1996 will represent the key years for the Veterans Independence Program, as it helps veterans to avoid permanent institutionalization for as long as possible. In the last five years of the decade, the rapidly shrinking number of veterans will have a median age of over 75 and will make growing demands on the provision of long-term institutional care.

Exhibit 13.1

VETERANS AFFAIRS PORTFOLIO ORGANIZATION


Minister of Veterans Affairs
Chairman War Veterans Allowance Board
Chairman Pension Review Board
Deputy Minister Department of Veterans Affairs & Chairman Portfolio Executive Committee
Chief Pensions Advocate
Chairman Canadian Pension Commission
• Disability pension adjudication
• Disability pension administration
• Disability Pension District Offices
ADM Finance, Personnel & Administration
ADM Pensions, Health & Social Programs replaces ADM, Veterans Services
ADM Field Operations replaces ADM, National Capital Operations
ADM Veterans Land Administration
• Finance
• Personnel
• Management Services
• Disability pension payment services
• Policy for:
- War Veterans Allowance
- Health
• Regional & District Office delivery for:
- War Veterans Allowance
- Health
• Departmental Health Institutions
• Ministerial Support

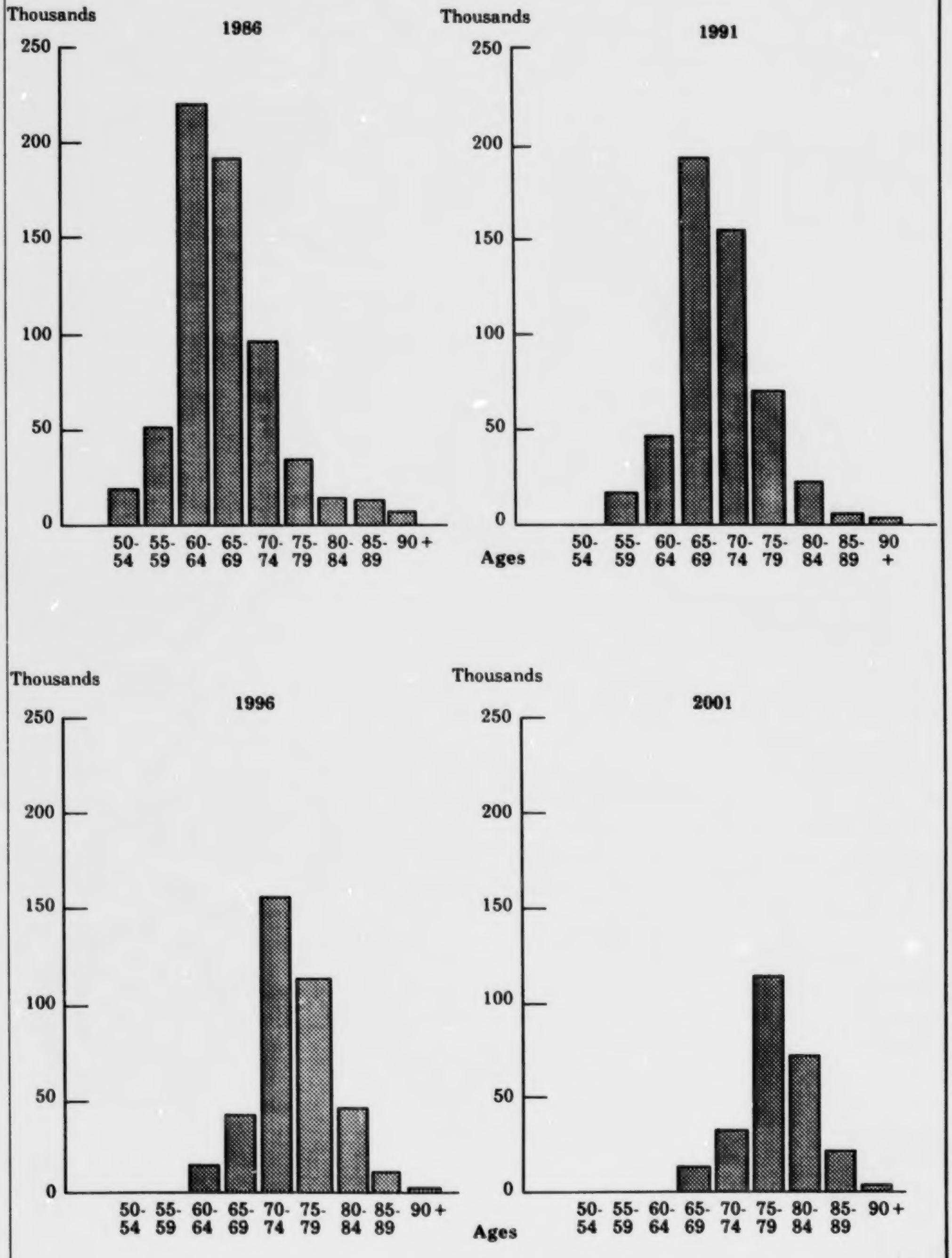
The arrows and shaded areas show the Portfolio's restructuring.

13.16 For the Portfolio to meet these changes in an economic and efficient manner, considerable planning will be required to ensure that resources are diverted from programs with declining demand into areas of growing demand. This is the challenge for the Portfolio for the rest of this century.

13.17 A final feature of the Portfolio's environment that should be noted is the view held of it by Members of Parliament. On 27 May 1986, the Minister and senior management of the Portfolio appeared before the Standing Committee on Veterans Affairs to answer questions on the Portfolio's Estimates for 1986-87. In tone and content the hearing praised the Portfolio and its programs. In particular, the Veterans Independence Program received much attention. Members pointed out the future importance to the country as a whole of the experience gained in this program. The praise was extended by all three political parties. At the conclusion it was moved and passed unanimously that the Committee report the Estimates of the Portfolio to the House of Commons without amendment.

Exhibit 13.2

AGING OF THE VETERAN POPULATION



Departmental forecast based on 1971 Census data.

Audit Scope

13.18 The primary focus of the audit was on the three major expenditure areas of the Portfolio: the War Veterans Allowance program, the Disability Pension program, and the Health Services program. We did not audit the three smaller agencies because of their relatively small size. However, where specific issues in the main programs led to these agencies, we did pursue them. The Department and the Pension Commission were the major focus of the audit. Since the restructuring of the Portfolio, completed on 1 April 1986, the aspects of the Commission's operations that were the major focus of our audit work have been integrated into the Department.

13.19 In addition to auditing the major programs, we examined a number of the corporate functions in the Department, particularly with respect to their relationship to the main programs. The functions examined included: strategic planning, program evaluation, performance measurement/management information, electronic data processing management, personnel management and financial management and control. The examination of the last area was more intensive because the Portfolio was part of the sample for the Office's government-wide study of financial management and control to be reported in 1987.

13.20 Financial management and control is an activity that extends well beyond such essential matters as keeping complete accounts and doing the related sums correctly. It is best described as an attitude that all managers, not just the departmental bookkeepers, must bring to all aspects of their work. At its root it involves in each activity a concern for the financial implications of actions and a conscious and systematic effort to ensure value for money in both the short and medium term. An examination of this would accordingly involve a number of areas of management including planning and budgeting, program delivery and related accounting and control, and realistic monitoring – including reporting and action where necessary.

13.21 We did not audit internal audit because it was reviewed as part of the 1984 government-wide audit of that function. In several areas we were able to rely on the value for money work done by the internal audit function. We also noted that in many cases their findings were similar to ours. For example, they warned the Department about incorrect War Veterans Allowance payments in 1983.

13.22 We also followed up on our audit note on trust accounts that appeared in last year's annual Report. This led to a wider investigation of all aspects of the Portfolio's management of veterans' funds in trust situations.

Veterans' Trust Accounts

Background

13.23 During our 1984-85 audit of the Public Accounts, we found irregularities in the accounting for veterans' trust accounts that we reported in Chapter 3 of our 1985 Report. Information uncovered in the course of that work and our subsequent discussions with the

Department led us to conclude that there might be further problems with the establishment and management of these accounts. We began by looking at the authority of the Department and the Pension Commission to establish and manage such accounts, and the standards they applied in doing so. In view of the large amounts of money held in trust – $56 million held by the Department and an unknown amount managed by third parties on behalf of the Department – we were concerned with the liability of the Crown if interest were to be owing on these amounts. Were interest to be owed, the liability could be very large and could well exceed the capital amount.

13.24 In this context it is important to note that it has only been very recently, through the Guerin decision of the Supreme Court (December 1984), that attention has been focused on the trusts administered by the federal Crown. This landmark decision clarified both the rights and obligations of the Crown in fiduciary situations (a trust is a special fiduciary situation). Prior to this decision, these matters had been unclear.

13.25 The War Veterans Allowance Act, the Pension Act and the Veterans' Treatment Regulations contain sections that permit the Department or the Canadian Pension Commission (CPC) to assume the management of money being received by a veteran if, in its view, he or she is incapable of managing those funds or is unlikely to use them to best advantage. The administration of all the veteran's funds (including Canada Pension Plan and Old Age Security/Guaranteed Income Supplement benefits) is undertaken in some cases. Many CPC recipients are also War Veterans Allowance recipients and in most cases these dual recipients' trusts are handled through War Veterans Allowance (WVA). Additionally, the Department is responsible for the trusteeship of trust funds arising, for example, out of bequests to the Department and from veteran estates, pending probate of the affairs of a veteran with funds in trust. These last types of trust were not covered by this audit.

13.26 Our examination of the statutes and the Department/Commission's procedures for dealing with these cases, and our review of documents used by the Department and the Commission, demonstrate clearly that the nature of the relationship established between the veterans and the Department or Commission is a trust. The Department and the Commission recognize it as such. While the legislation governing trusts is all provincial, this does not affect the federal power to establish such relationships. Nor does it bind the federal Crown to follow provincial legislation in doing so, although it may if it chooses. Based on their actions, it appears that the Department and Commission have chosen not to be bound by provincial law, and accordingly are governed by the common law of trusts.

13.27 We based our audit criteria on the common law of trusts. These criteria, in summary form, are a series of duties to be fulfilled by the trustee. In all of these the duty should be fulfilled to the standard of "reasonable persons of business administering their own affairs." These specific duties are:

- **The duty not to delegate.** The trustee may not delegate responsibility for the trust to another person, but appropriately trained and qualified persons may be employed to assist in their professional capacity. Where they are employed to assist in trust administration, the trustee must ensure that they are fully qualified and must provide reasonable supervision of their conduct. Ultimate responsibility resides with the trustee.

- **The duty to account.** The trustee must ensure that proper accounts and records of disbursements and decisions are maintained, and that accounts are rendered to the beneficiary at appropriate intervals.
- **The duty to invest.** The trustee must ensure that funds are invested in suitable instruments to earn a return for the beneficiary.
- **The duty to avoid conflict of interest.** The trustee must derive no benefit from the administration of the trust. In particular, no use may be made by the trustee of trust moneys or assets. The trustee must not enter into conflict of interest situations.

The Administration of Trust Accounts

13.28 **Establishing the trust.** The first area of concern is the process of declaring that a veteran is incapable of managing his or her affairs. The Department has few formal procedures or policies in this area. Those that it has are very general and seem not to be used.

13.29 The informal procedures used by the Department and the Canadian Pension Commission have evolved over the years in the various districts in response to the needs of their clients. However, the person whose rights are being affected is entitled to the following: a formal hearing; formal notice of the hearing; an opportunity to be present at the hearing and to be represented by counsel; formal notification of the determination; and some right of appeal. We are concerned that currently the Commission and the Department have virtually none of these procedures. We appreciate that it might not be practicable to follow them fully with all their clients.

13.30 **Delegation to, and supervision of, agents.** The practice in both the Department and the Commission has been, where possible, to find a third party to administer the trust account. If such a person cannot be found, the Department or Commission uses its own staff to manage the accounts.

13.31 **Third party delegation.** On finding a third party who is willing to act, departmental practice is to meet the person and explain that he or she will be getting the veteran's WVA cheque and is to administer the money for the veteran. The Department does not fulfil the duty to provide the delegate with the information and instruction necessary to manage the account, such as advice on opening a separate bank account, ensuring that the trust funds are in an interest-bearing account, and keeping proper records of transactions. There is little or no further contact with the administrator unless the administrator contacts the district office or the veteran complains that the money is being mishandled.

13.32 The Canadian Pension Commission does provide some guidance to third party administrators and requires them to sign an agreement on accepting the responsibility of administering a veteran's pension. In addition, the third party is required to account annually, by completing a form, for the expenditure of trust moneys. They are not required to produce bank statements, and their accounts are not audited. If any irregularities are found or complaints arise, administrators may be removed and others appointed to act. In all these ways, the Commission is making an attempt to supervise third party administrators as required.

13.33 In spite of these efforts, the guidance and supervision of these third parties by the Department and the Commission fall short of what would normally be envisioned as proper in using them to assist the trustee in administration of the trust. Effectively the role of trustee has devolved on these persons, although the Department/Commission continues to be the trustee and is accountable for third party actions in that role.

13.34 **Staff administration.** If the Department cannot find a third party, then it administers the account. This is also problematic. First, there are no formal instruments of delegation that would provide authority for anyone other than the Minister to administer the trust.

13.35 Second, no training in trust administration is provided by the Department. Knowledge of this area is not a basic requirement for a counsellor's job and it is not even included in the job description. The counsellor has always been considered a caseworker rather than a trust administrator.

13.36 In addition, neither counsellors nor employees dealing with the financial administration of trusts have any real knowledge of the responsibilities associated with trust accounting; further, there are no procedural guides and policies. The result is that persons who have no real knowledge of the trustee's duties administer trusts as they see fit with virtually no formal guidance.

13.37 As a result of this lack of guidance, the conduct of the administration varies according to the region and district involved. Some districts try to help veterans gradually to take control of their affairs until they no longer need the Department's assistance. This process has assisted one district to decrease its administered case load from 160 in 1980 to less than 30 at present. Most other districts have no such programs and maintain many people on administration for years.

13.38 We observed that the standard of practice in the Department's administration of foreign trust accounts, while not up to the required level, was better than the practice overall.

13.39 The Department has few procedures to ensure that the overall standards of care are maintained. There are informal means in some districts for checking the validity of disbursements from trust accounts. However, there are not sufficient controls to ensure that they are reasonable and in the beneficiary's best interest. This creates a possible liability on the part of the Department for failure to fulfil its duty to supervise its agents.

13.40 CPC trust administration raises much the same problems as WVA administration. Because administration of these trust accounts is only a small part of the

CPC staff's jobs, they receive no specific training and have no specific knowledge of the trustee's standard of care.

13.41 **The duty to account.** Although a trustee has a basic responsibility to keep accounts and all documentation regarding the trust, we found that the Department is generally unable to render a complete accounting on most accounts or any accounting on WVA accounts administered by third parties. Supporting documentation and justification for disbursements from accounts was insufficient or non-existent, although such documentation is necessary to prove that funds were actually requested and paid, and were paid for a proper purpose. Especially where a trust is being administered for a person unable to care for himself or herself, we would expect such documentation to be on file to show good faith on the part of the trustee. Such documentation would also guard against any allegations of fraud or mismanagement.

13.42 In addition, we found there was no regular reporting to veterans on the state of their accounts. Beneficiaries are entitled to regular statements and a final statement at the conclusion of the trust.

13.43 **The duty to invest trust funds.** One of the most basic duties of the trustee is to invest trust funds. He or she must use prudence in selecting good investments and ensuring they are suitable, given the terms of the trust and the interests of the beneficiaries. The Department does not invest or pay interest on money held in any trust account. Where veterans have raised the matter of receiving interest, they have been told by departmental officials that such arrangements are not possible.

13.44 As a trustee, the Department has a responsibility to invest trust funds in approved investments and account to the beneficiary regularly. The Department is vulnerable to legal action by veterans to recover the difference between the amounts accumulated in the trust accounts and what would have been produced if the money had been properly invested. Given the amounts involved and the length of time that many of these accounts have been in existence, this liability could be large.

13.45 **Conflict of interest and duty: Crown self-dealing in trust funds.** While there does not appear to be a conflict of interest problem with staff employed by the Department, the Crown as trustee may be viewed as being in a position where its interest and duty conflict. Technical self-dealing arises with respect to the Crown's failure to invest or pay interest on moneys held in trust accounts in the Consolidated Revenue Fund.

13.46 **Implications.** The Department and the Commission recognize that a trust relationship exists with their administered account clients. However, neither has met the minimum obligations of this situation. Recipients whose affairs have been administered by the Department have, at best, had the benefit of its good intentions. However, they have been deprived of the investment value of their funds. Those whose affairs have been placed in the hands of third parties may in some instances have had the benefit of some interest on their funds, but at the cost of having their affairs left unsupervised.

Departmental Action

13.47 The Department and the Commission have taken a number of actions to clarify their responsibilities and correct these problems. They acted promptly once the matter was drawn to their attention. For example, the CPC has taken steps to wind up a large number of dormant files and has tried to place fewer accounts under administration, breaking with past practice. In addition, a Task Force on Trusts has been appointed to review all aspects of the management of trust funds, estate funds and trust accounts. The project is in two parts. The first part is to develop and implement procedures to deal with the accounting problems featured in our 1985 audit note, and to document the Portfolio's obligations. The second is to make recommendations to senior management on how to proceed. This task force is to complete its work by fall 1986. As stated earlier, the Guerin decision has only recently begun to attract attention to these problems.

War Veterans Allowance Program

Background

13.48 Some 84,000 eligible veterans and civilians and their dependants receive monthly cheques under the War Veterans Allowance program. It is an income support program, with the amount of monthly benefits determined by an income test. To be eligible, normally the veteran or civilian must have reached the age of 60 and have served in a theatre-of-war or have been disabled.

13.49 In 1984, significant changes were made to the War Veterans Allowance Act. One of the major thrusts of the amendments was, for reasons discussed in the rest of this section, to bring the income definitions and procedures for reporting income more closely in line with those used in the Guaranteed Income Supplement. This process, known as "Harmonization" in the Department, will enhance its ability to co-ordinate program delivery more effectively with the Department of National Health and Welfare, and will also help in reducing the long standing problems that the Department has had with over- and under-payments.

13.50 We examined planning for the program, considered whether due regard had been given to the efficiency and effectiveness of program operations, and examined the adequacy of financial management and controls. Our observations are related to the following major challenges we believe management faces:

- significant numbers and amounts of incorrect payments to recipients;
- financial control inadequacies;
- significant operational inefficiencies; and
- long-term planning inadequacies.

Incorrect Payments

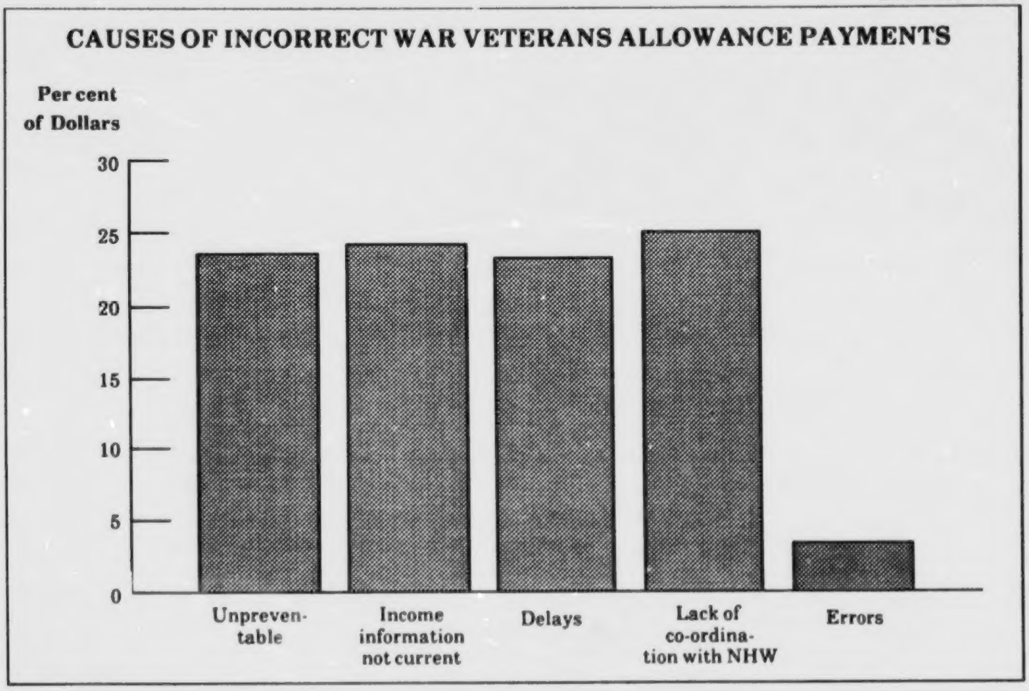
13.51 The War Veterans Allowance program has had a rising incidence of incorrect payments. We first raised this issue in our 1980 Report, noting that the annual total of incorrect payments had doubled over the previous six years to $11.3 million. In each subsequent year, we have reported to the Department that incorrect payments are rising. We have made these annual estimates because the Department has not kept complete records of incorrect payments and thus has not had systematic information on their amounts or causes. Departmental internal audits have also reported to management a trend of increasing incorrect payments.

13.52 For 1985-86, on the basis of a review of 200 client files, we estimate that there have been $9.4 million in overpayments to clients that were not preventable under the operating policies and procedures in effect during the period under audit, $26.4 million in overpayments that could have been prevented, and $3.8 million in underpayments to clients. Because of the effects of sampling errors, we estimate the total value of overpayments of $35.8 million has a possible range of between $22.9 and $54.6 million. The underpayments have a possible range of between $1.4 million and $14.6 million. Both ranges are based on a 95 per cent confidence interval.

13.53 The amount of incorrect payments is considerably larger than the approximately $20 million the Department spends annually to administer the program. The majority of the incorrect payments could have been prevented through a combination of legislative changes and comparatively inexpensive changes to operations. Nearly a quarter are not preventable under the legislation, procedures and policies in effect during our audit; for example, where the Department receives notice of an income change after the cheque for the affected month has been sent. The frequency of these unpreventable incorrect payments should decline after April 1986 with the introduction, as part of Harmonization, of a simpler income test based on the previous year's income. Four other causes that could be prevented account for the remaining three-quarters of the incorrect payments (see Exhibits 13.3 and 13.4).

13.54 The first of the four is a legislative overlap problem between the Department and National Health and Welfare, at the time a recipient applies for Old Age Security, Canada Pension Plan and/or Guaranteed Income Supplement. This accounts for a quarter of the incorrect payments. Pursuant to WVA Act and regulations, the Department is obliged to continue to pay WVA from the time a WVA recipient is eligible for OAS/GIS until it is granted by the Department of National Health and Welfare. On occasion, this may be much later if there is a problem in establishing eligibility. In such cases, National Health and Welfare pays a retroactive lump sum for the time since the person became eligible. There is no provision in the law to deduct the amount received under WVA. In effect, the recipient gets paid double until the application is approved. The Department does inform the recipient that he or she should apply for OAS/GIS. However, the Department could take further actions to minimize the double payments. In our opinion, most of these double payments could be prevented or reduced if the two departments worked together to co-ordinate the granting of OAS/GIS to WVA recipients. As well, the Department suggests that, with a legislative change, National Health and Welfare could simply subtract the WVA overlapping payment from the retroactive lump sum payment for OAS/GIS.

Exhibit 13.3



13.55 **The Department of Veterans Affairs should attempt, in conjunction with the Department of National Health and Welfare, to eliminate the incidence of double payment of income support benefits to veterans.**

> Management's response: *The possibility of a legislative change to permit recovery of overlapping payments is being pursued. Also, as mentioned by the Auditor General, the Department is in the process of implementing Harmonization and the transfer, by magnetic tape, of the necessary data. These three measures should eliminate most, if not all, of the double payments.*

13.56 An equally important cause, accounting for almost a quarter of incorrect payments, was the failure to ask clients regularly to report their income and domestic status. The Department's policy is to request information annually only from those clients considered most susceptible to income fluctuation.

13.57 As a result, about one-third of clients had not been asked since 1983 to report income information. One in every eight had not been asked since 1980 to report income information. Hence, the information on which payments were based was sometimes more than five years old. In many of these cases income had changed, so the recipient was receiving too much or too little from WVA. Most of these cases should be eliminated by the planned tape-to-tape transfer of income data from National Health and Welfare (see paragraph 13.76) and a proposed increase in departmental requests for income information.

Exhibit 13.4

INCORRECT WAR VETERANS ALLOWANCE PAYMENTS

To get an estimate of the magnitude and causes of incorrect payments under the War Veterans Allowance program, we examined a random sample of 200 client files. A cheque for a particular month was selected, and we determined whether the amount was correct. We also looked at the total incorrect payment, if cheques were in error for some time. The following is a selection.

Case 1. Excess payment of $530.10 for audited month where Department acted promptly.

The recipient, a widow, became eligible for Old Age Security Spouse's Allowance in September 1985. She informed Veterans Affairs of this in a letter received 16 October 1985. The Department reacted to this information within five days. However, if WVA and OAS/GIS payments were fully co-ordinated, incorrect payments of this type would not need to occur. This prompt action limited the excess payment to $530.10.

Case 2. Excess payment of $227.17 for audited month from failure to require regular income reporting.

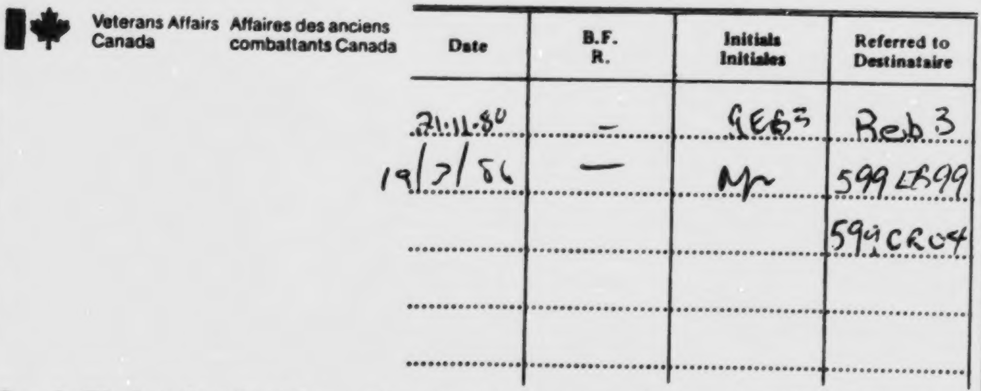
The recipient, a widow, was last asked to report income in 1980. At that time, she reported sizeable business losses which resulted in no net income. Her business interests included equity in a small printing business, a small marina, rented farm land, and a rented house. At our request, the Department contacted the recipient and determined that she had a 1985 net income of $5,600. The total amount of excess payments between 1980 and 1985 is not known.

Case 3. Underpayment of $109.66 for audited month due to departmental errors.

The veteran advised the Department of $8,450.00 of earnings income. Departmental staff made several arithmetic errors in calculating the effect of this income on benefits. The error had not been detected at the time of our audit, by which time the veteran had been underpaid by a total of approximately $1,400.

Case 4. Excess payment of $167.76 for audited month due to departmental delays.

The recipient, a widow, reported in late September 1985 that she was receiving Canada Pension Plan survivor benefits, following the death of her veteran spouse in December 1984. The Department acted on this information effective January 1986, resulting in excess payments in each of the intervening months totalling approximately $500.



Veterans Affairs Canada Affaires des anciens combattants Canada

Date	B.F. R.	Initials Initiales	Referred to Destinataire
21.11.80	–	GEG3	Reb 3
19/7/86	—	Mr	599 LB99
			599 CR04

Case 2. The last time this file was signed out, before our audit team signed it out in 1986, was in 1980, when the client was last contacted.

13.58 The third cause, again accounting for nearly a quarter of incorrect payments, was departmental delays in acting on notification of changes in a recipient's income or circumstances. Some improvements were made with the introduction, on 1 April 1986 as part of Harmonization, of a new computer program enhancement that more quickly processed income changes resulting from the annual income solicitation. As well, the Department used specially recruited staff to handle the annual income reporting. By the end of April, action had been taken on all notifications from the income solicitation received by that date.

13.59 The Department has acted on one of our 1980 recommendations by establishing procedures and an electronic data processing system to anticipate significant changes in a client's income. Although the Department did not always fully adhere to these procedures, we noted that incorrect payments had been reduced where they were followed.

13.60 Management could have taken further action to minimize delays at comparatively low cost, but did not. For example, in one region, 20 per cent of notifications had not been acted on five months after receipt. We found that management was not ensuring that the most significant notifications were identified and acted on first. Nor in the past had sufficient use been made of temporary or part-time staff during monthly and annual peaks in activity. As noted above, temporary staff were used this spring to deal with the volume from annual income solicitation.

13.61 The fourth cause of incorrect payments, accounting for less than 5 per cent, was administrative errors by program staff. These included arithmetic errors, failure to grant income exemptions, and incorrect interpretation of notifications from clients. Such errors occurred despite the existence of two separate quality control processes designed to detect them.

13.62 In summary, the Department has taken or is in the process of taking a number of actions through Harmonization that should, among other things, lead to reductions in incorrect payments, but more could be done as a number of other cost-effective solutions exist.

13.63 **The Department of Veterans Affairs should institute additional procedures, including establishing clear processing priorities, to ensure that incorrect War Veterans Allowance payments are held to a minimum.**

> _Management's response:_ *As noted by the Auditor General, the Department changed its procedures for processing annual income reporting in April 1986, and eliminated delays previously experienced in this area. As well, the Department plans to minimize processing delays in other areas. These steps, together with those mentioned in reply to the first recommendation should ensure that incorrect War Veterans Allowance payments are held to a minimum.*

Financial Management and Control

13.64 Many of the same financial management and control issues we found elsewhere in the Department were evident in the War Veterans Allowance administration. In particular, there was an absence of essential financial controls and of accurate program costs.

13.65 **Financial controls.** The most essential control in a financial system, and one that is required by the Receiver General, is the periodic reconciliation of independent sources of information. The Department did not design its procedures to permit reconciliation of the Veterans Services/Benefit Delivery System, (see Exhibit 13.5) and the government-wide Departmental Reporting System (DRS) in which all transactions with an effect on the Accounts of Canada are recorded. Hence, no reconciliations are performed to ensure that the two principal systems in which WVA expenditures are recorded agree.

13.66 As part of the Department's submission for the Public Accounts of Canada, it signs a certificate to the effect that the financial statements contain accurate and complete data. Although the systems do not reconcile, and errors are present, the certificate has been signed by the Department each year.

13.67 We found similar problems in controls over the recovery from clients of excess benefit payments. As a result, the Department has collected too much or too little from some clients. As well, the amount of recovered or forgiven excess payments reported in the Public Accounts of Canada is incomplete and inaccurate.

13.68 **Program costs.** Little accurate information on the costs of administrating the program is available. For example, the Department's financial systems, Part III of the Estimates, and the Public Accounts report that WVA uses approximately 700 person-years. Studies by the Department reveal that 400 to 500 staff are actually used by the program. This lack of agreement is a result of not having a system that records staff time spent on different programs.

13.69 The Department has informed us that action is being taken to deal with each of these accounting problems. In the case of the reconciliation, results are expected by the end of the fiscal year.

Operational Efficiency

13.70 War Veterans Allowance program operations consist of three essential processes:

- processing new applications, which involves determining and verifying the applicant's service eligibility, income and age or health status;
- maintaining information on existing clients, which involves recording and calculating the effect of changes in income or domestic status; and
- issuing monthly cheques.

13.71 We examined whether management had given due regard to the efficiency of program operations. In particular, we examined whether past electronic data processing investments had realized their efficiency objectives, and whether management had systematically measured efficiency and acted on the results.

Exhibit 13.5

DEVELOPMENT HISTORY OF WAR VETERANS ALLOWANCE COMPUTER SYSTEM

1978	Development of the Veterans Services Benefit Delivery System (VS/BDS) began along with the Canadian Pension Commission System (CPC/BDS). The projected cost: $2.3 million. Operating costs were not considered to be significant.
1980	We reported that the system had not been implemented and the projected cost had risen to $9 million. The Department projected VS/BDS savings of 155 person-years and $1 million reduction in excess payments.
1982	Treasury Board, concerned about delays and cost, estimated project cost at $15.5 million, annual operating costs at $3.8 million.
1982, 83	The first phase of the system was implemented nationally.
1984	Project was completed.

We estimate that the total development cost was at least $17 million, with annual direct operating costs of $4.4 million, plus a portion of an unallocatable $3.7 million for EDP overhead.

We found that few of the promised 155 person-year reductions have been made. The system permits staff to process 25 per cent more work (the equivalent of no more than 50 person-year savings) but workload has gone up commensurately, and staff reductions have not occurred. The Department cannot fully explain the increase in workload because the number of clients has not increased. The Department believes that some increase is due to administrative changes made to implement War Veterans Allowance Board decisions.

Excess payment control has not improved; the planned excess payment control module was dropped to minimize cost overruns and delays. Some excess payments have been avoided by a module that anticipates changes in client income.

In our review of the efficiency of WVA operations, we found that the system could have been designed to yield greater productivity improvements.

Staff recopy and rekey information that is already computer-stored. Using the information already in the computer and eliminating the printout would reduce time needed to make a change by 25 per cent.

13.72 The question of WVA operational efficiency will be increasingly important during the next 15 years. As benefits fall dramatically, it is critical that management be continually aware of opportunities for improving efficiency to ensure that processing methods are appropriate to the reduced scale of operations.

13.73 We found that management was concerned with operational efficiency and had taken two significant actions to improve it. It introduced changes in the handling of client contacts – the "service policies" of the program – and, through amendments in 1984 to the War Veterans Allowance Act, made program operations harmonize with, or parallel more closely, the operations of the Old Age Security/Guaranteed Income Supplement.

13.74 The changes to service policies reduced the contact between field counsellors and clients by, for example, having applicants mail applications rather than applying in person. War Veterans Allowance operations could then be centralized from district offices in the field to larger regional offices. As a result, the Department estimated that by November 1985, 130 person-years were made available for reallocation to the growing Veterans Independence Program (VIP).

13.75 This transfer of resources arises from an agreement made at the time the extension to VIP and the Harmonization initiative for WVA were approved. The agreement was to use resources saved from operational enhancements, such as the new service policies, and declining work from WVA to provide staff for VIP.

13.76 The Harmonization initiative resulted from studies, including a 1983 program evaluation, of whether the War Veterans Allowance could take advantage of the existence of the Guaranteed Income Supplement program. The similar purposes and similar client base of the two programs have caused many observers, including the Public Accounts Committee, to ask about the feasibility of integrating them. Departmental studies concluded that integration was premature because a sizeable number of clients have yet to reach 65, but that administrative savings would result from some harmonization of the programs. Savings would come partly from adopting aspects of the GIS income test to calculate benefits, but more significant savings would result from eliminating duplication in income reporting by clients. Those over 65 would report income changes to the Guaranteed Income Supplement, and the War Veterans Allowance program would rely on the GIS information that it would receive from a tape-to-tape transfer of the data from the Department of National Health and Welfare. When the necessary computer link is established, the Department anticipates that staff requirements will be reduced by 70.

13.77 These initiatives illustrate the Department's regard for improving efficiency. On the other hand, full implementation of the Harmonization initiative was delayed when the Department decided to postpone the tape-to-tape transfer of income data and concentrate on implementing the new income test that came into effect 1 April 1986. According to the Department, this decision was based on National Health and Welfare's assertion that it could not respond by 1 April 1986, and further, on the Department's view that the disruption arising from an attempt at full implementation in a single step would degrade levels of service. When it is fully implemented, we estimate that savings of at least $15 million resulting from the combination of reduced incorrect payments and staff savings can be achieved. At the end of our audit the Department was preparing a Treasury Board submission for approval to proceed.

13.78 Although it has acted to improve efficiency in some areas, the Department has not systematically analysed and improved the efficiency of other key operations of the program. The fundamental source of inefficiencies is the design of the Veterans Services/Benefit Delivery System that is used to maintain information on clients and issue monthly cheques.

13.79 The Department spent at least $17 million between 1978 and 1984 designing and implementing the system. Exhibit 13.5 gives the history of the project and explains why, in our opinion, it did not yield sufficient value for money. Although its objective was to save 155 person-years, the productivity improvement was much less than promised.

13.80 In conjunction with departmental personnel, we determined that the design of the system could be improved. For example, computer-generated letters could provide clients with the same information as letters currently written by staff, and reduce the time needed for each case by 20 per cent. Management has a series of options that it agrees are cost-justifiable, from relatively inexpensive measures to a major redesign of portions of the system. The Department informs us that it plans to make system enhancements once the tape-to-tape link with National Health and Welfare is complete. In any event, changes in program administration would have to be acceptable to the War Veterans Allowance Board, which hears appeals by recipients on departmental adjudications. In the past, the Board has reversed administrative changes when it felt that these adversely affected recipients or the quality of service available to them.

Program Planning

13.81 The WVA program faces fundamental changes in the income support needs of its clientele. As recipients turn 65, they become eligible for Old Age Security benefits and, because of their low income, the Guaranteed Income Supplement. Upon receiving OAS/GIS, the veteran's monthly WVA benefits are reduced by the same amount. Recipients under 65 receive average monthly benefits between $625 (single veterans) and $850 (married veterans). Those receiving OAS/GIS receive average monthly benefits of less than $100 from WVA in addition to their OAS/GIS payments.

13.82 As a result of this and other factors such as mortality, the relative importance of the program will decrease dramatically over the next 15 years. This is evident in the forecast of program expenditures in Exhibit 13.6, showing a drop in benefits from $450 million to $40 million over the comparatively short span of 15 years. This creates the need for considerable long-term planning to guide the program.

13.83 We found that, although short-term plans had been developed, there is no long-term plan for the War Veterans Allowance program. As a result, fundamental decisions have not been made on the future of the program through the medium and long term.

13.84 A major challenge for the Department is keeping administrative costs in line with benefits paid. At present, the monthly cost of administration exceeds $20 a client. This cost becomes comparatively more significant as cheque amounts drop to less than $100 a month.

13.85 The possible future directions for the program have been identified in both the Nielsen Task Force report on Veterans Affairs and in a recently completed internal study. The identified options include a number of possibilities ranging from maintaining the status quo to changing the program to operate on the same basis as the GIS. The options are not mutually exclusive in that some may be more attractive in the short run and others may become more attractive in the medium term (1991-1993) as the number of clients under 65 declines to a fairly small proportion of the total client base (see Exhibit 13.7).

13.86 The need to decide on the long-term administration of the program is urgent because the option or sequence of options selected will affect departmental actions in the short term. In particular, decisions taken now could well affect in a material way the nature and direction of electronic data processing development work for the program.

13.87 **The Department of Veterans Affairs should establish a long-term plan for the administration of the War Veterans Allowance program that includes the actions to be taken now to ensure the most economic and efficient evolution of the program.**

> *Management's response: The Department is in the process of developing a long-term plan for the administration of the War Veterans Allowance program. Possible options have been identified, but further consideration of these options is still required. However, initiatives such as Harmonization have been designed to ensure that any of the identified options may still be chosen at a later date.*

Disability Pension Process

Background

13.88 In delivering $788 million in benefits to an average of 138,000 recipients, the disability pension process involves the interaction and co-operation of four independent agencies within the Veterans Affairs Portfolio. The Bureau of Pension Advocates prepares veterans' cases; the Canadian Pension Commission provides medical and administrative support for decisions and appeals and is responsible for the initial decision on a pension and the first level of appeal; the Department pays pensions and recovers overpayments; and the Pension Review Board serves as the final tribunal of appeal on pension matters. Effective 30 January 1986, many of the Canadian Pension Commission's support function responsibilities and staff were transferred to the Department under the new Assistant Deputy Minister, Pensions, Health and Social Programs. On 1 April 1986, the staff in the pension pay area were transferred to this branch as well (see Exhibit 13.1).

Exhibit 13.6

DEPARTMENTAL FORECAST OF WAR VETERANS ALLOWANCE EXPENDITURE

($ millions)

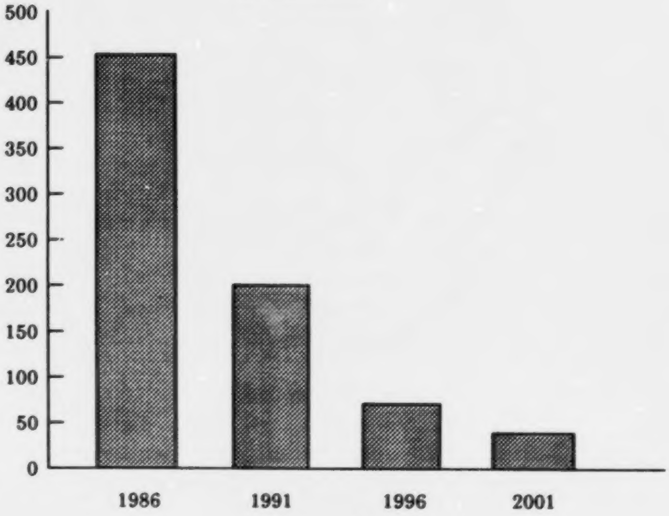
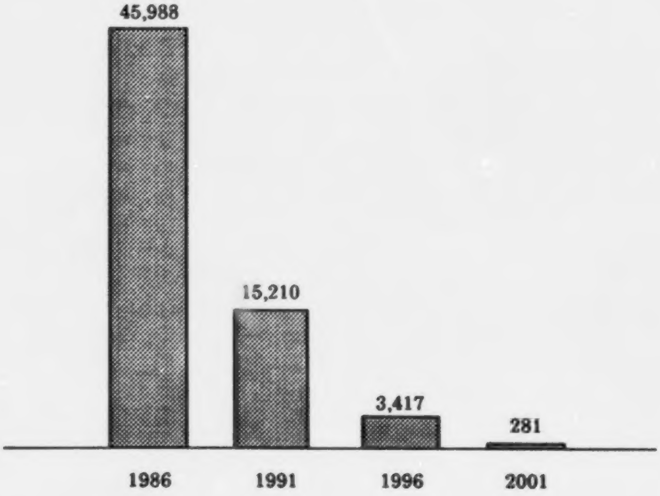


Exhibit 13.7

DEPARTMENTAL FORECAST OF NUMBERS OF WAR VETERANS ALLOWANCE RECIPIENTS UNDER 65



13.89 The disability pension process has been the subject of close scrutiny for many years. Our 1980 Report, the Tenth Report of the Public Accounts Committee (1981), the McCracken Study (1982), the Marin Committee (1984) and the Nielsen Task Force (1985) have all reported on its problems. Most of these studies focused on the inability of the process to adjudicate disability pension cases promptly.

13.90 Our 1980 Report noted the length of time that the pension process seemed to be taking, and we recommended that the Canadian Pension Commission formalize processing time standards in all areas of the pension adjudication process within its control.

13.91 The Tenth Report of the Public Accounts Committee, 23 November 1981, recommended that:

- the Canadian Pension Commission provide your Committee with a report by March 31, 1982 indicating the resource costs, and the systems and legislative changes which would be required to enable the Commission to process pension applications through all levels in a maximum of 180 days; and
- the Canadian Pension Commission take measures to expedite its pension settlements.

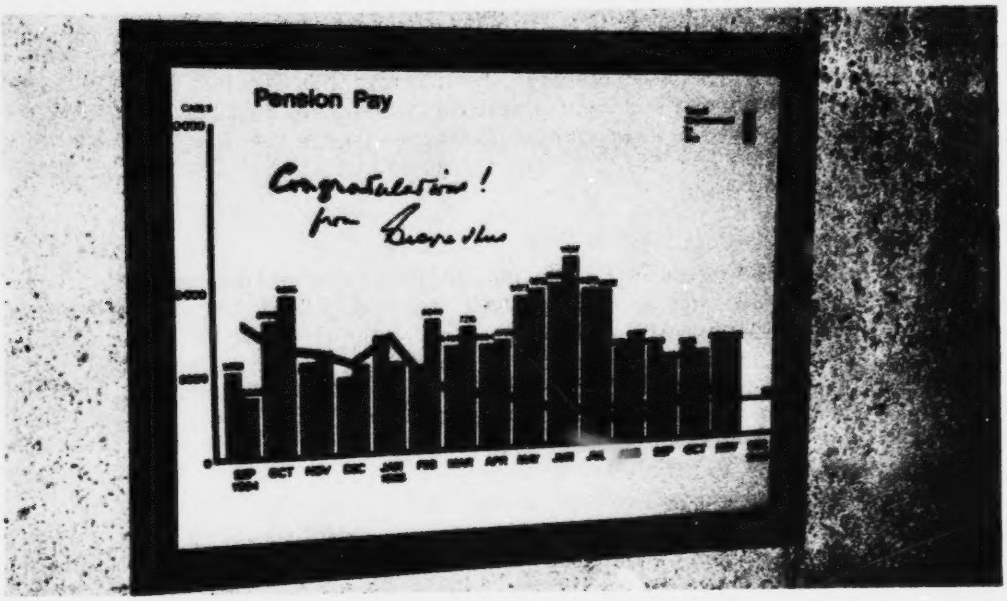
13.92 In February 1982, the McCracken Study Report to the Minister recommended 38 ways to improve the disability pension process, 22 of which have since been implemented in whole or in part.

Pension Process Task Force

13.93 By mid-1984, as a result of a wide variety of factors including the move to Charlottetown, repeated failures of the computer system, and lack of inter-agency co-operation, the pension process was the object of severe public criticism. In response to this the Minister established the Special Committee to Study Procedures Under the Pension Act (the Marin Committee). It submitted a report in November 1984 at the request of the new Minister, who appointed an internal Task Force to examine and organize the issues identified in the Marin report and in submissions and letters to the Marin Committee.

13.94 The Task Force examined the reports on the process as well as 29 briefs and submissions and 110 letters to the Minister. It extracted 237 issues and analysed them in terms of how they were related to the process, who was responsible for addressing them, how they should be addressed, how long they should take to resolve, and whether they could be addressed within the present legislative framework.

13.95 The Task Force report, issued in September 1985, listed the improvements made to the process between October 1984 and 30 June 1985 and concluded that "significant progress had been made in speed, courtesy and generosity in treating veterans' claims." Our analysis of the report identified 41 actions that had been taken.



The Portfolio proudly displays the Minister's assessment of its performance in dealing with the backlog in processing disability pensions. The trend line shows a declining backlog of unprocessed applications (see paragraph 13.96).

13.96 The public perception that turnaround times were unreasonably long was one of the major criticisms leading to the Marin Committee. Immediate and intensive effort was directed to the task of achieving significant reductions in the time taken to do the processing. In view of the continuing problems from the move (see also Exhibit 13.8), achieving significant reductions in turnaround time was to be, for those involved in the disability pension process, a long and very difficult task. It took over a year to bring levels down to the current levels of performance. The photo shows the Minister's evaluation of the result.

13.97 In our opinion, the Task Force met its objectives of identifying concerns that could be corrected immediately and expediting action, arranging for study, and making further recommendations for corrective action. Most significantly, it established clear priorities and a precise definition of the key problems and issues that faced the management of each of the disability pension process organizations. It also forced managers who had not co-operated before to agree on the best means of dealing with the issues raised, and aided in identifying significant variances and gaps in the systems used to measure turnaround times within the Portfolio.

Turnaround Time Measurement

13.98 Our 1980 Report observed that the systems necessary for measuring turnaround times were not in place. One of the early findings of the Task Force was that there were no accurate measures of these times within the Portfolio. We found that in general the systems are now there, although there were some exceptions, and there were gaps in the measurement procedures.

13.99 We selected a sample from cases on which a first decision was being made and determined that the processing time – from the date of intent to apply to the date the case was entered into the delivery system as "in pay" – was longer than reported by the Pension Process Task Force. The Task Force figures were compiled from individual reports from the organizations involved in the process. Our sample results for the month of December 1985, estimate a mean processing time of 13.2 months compared with a mean value of 11.0 reported by the Task Force for that month.

13.100 The Pension Process Task Force and the Minister's announcements indicate that the average processing time has been significantly reduced. Although our sample indicated somewhat higher values for average processing times than the data produced by the agencies, it also indicated that turnaround times have decreased by a magnitude similar to that reported by the agencies.

Disability Pension Process Efficiency

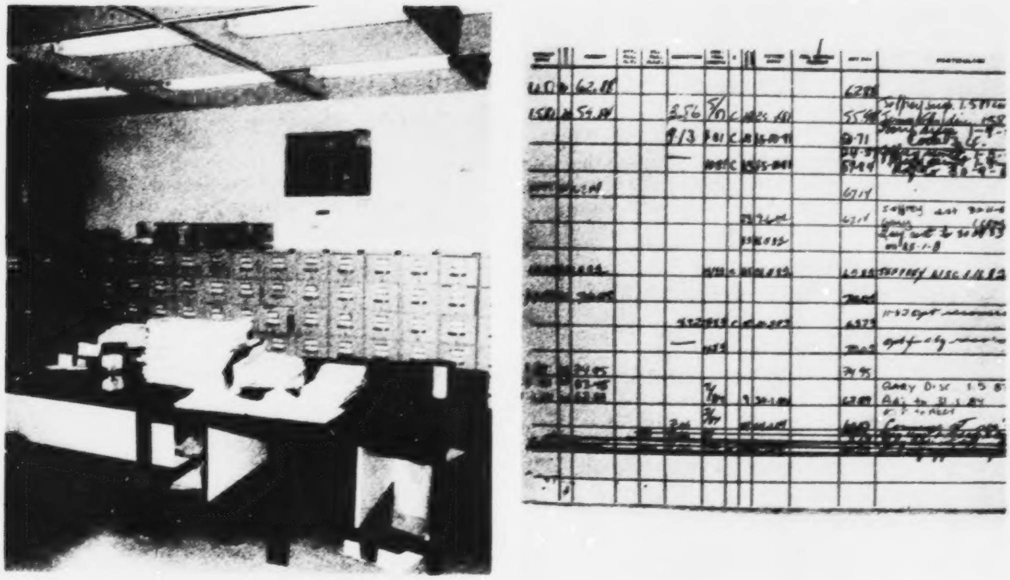
13.101 A number of internal reports and the Nielsen Task Force report have indicated that, in spite of the reduction of the backlog and turnaround times, improvements in the process also need to be pursued to correct inefficiencies in operations.

13.102 We examined the efficiency of the process in two areas – adjudicative support and pension pay. We found only minor inefficiencies in the work flow methods used in adjudicative support.

13.103 In the pension pay area, we concentrated on pay calculation and, in particular, on the potential for gains through automating this and related processes. Management in the pension pay area had been conducting pilot investigations into the possibility of automating the calculation process with microcomputers. We found that, while there was little gain to be had from automation of the calculation process itself, it was an essential prerequisite to steps that could yield significant benefits. We determined that the greatest potential for savings, and/or reductions in turnaround times, lay, once the calculations were automated, in entering the calculated data directly, keeping an electronic payment history file, and modifying the payment verification process.

13.104 Establishing a procedure for direct data entry of the calculation results would eliminate the need for manual transcription, key entry and verification, and rechecking of results. A payment history data file would greatly speed the calculation process and, over time, would eliminate the need to maintain the hundreds of thousands of manually kept ledger cards that make up the current history record. It would also result in better control over payment history. At present, control over the physical access to this history is inadequate. These two steps would, in turn, allow significant modifications to be made to enhance the productivity of the payment verification process.

13.105 We estimate that with these changes productivity gains of the order of 25 per cent could reasonably be expected. This level of improvement would make the necessary EDP investment cost-justified. Management may choose to take these gains in the form of reduced turnaround times, reduced labour costs or some combination of both.



The filing cabinets hold over 200,000 manual payment record cards for disability pensioners. There is a lack of physical control over these records. The close-up of a manual payment record card shows how changes in payment status are recorded. The last entry has been deleted without any authorizing signature (see paragraph 13.104).

13.106 Management has for some time recognized the need to improve the pension pay area, but for a variety of reasons has not implemented the changes that would have made these improvements possible. One reason was the failure of the Canadian Pension Commission/Benefit Delivery System (CPC/BDS) to automate the calculation process and payment history as had been expected by management. Management has been constrained by the need over the past 18 months to devote all the energy of those involved in the benefit delivery process to reducing backlogs to acceptable levels. Exhibit 13.8 sets out the key findings with respect to the problems with the Benefit Delivery System.

13.107 The Department has expressed concern about the shortcomings of the CPC/BDS. A project was initiated to investigate alternatives for improving the process through additional automation, including a preliminary proposal for extensively redeveloping most of the CPC/BDS.

13.108 **The Department of Veterans Affairs should take prompt action to achieve the level of efficiency that is possible for the disability pension process.**

> Management's response: *The Department has devoted considerable resources during the last two years to achieving the dramatic reduction in turnaround times referred to by the Auditor General. In addition, with the consolidation of all of the administrative aspects of the disability pension process under a single management, the Department will be making every effort through changes to computer procedures and work methods to achieve a level of efficiency concomitant with the human and financial resources available.*

Exhibit 13.8

DEVELOPMENT HISTORY OF THE DISABILITY PENSION COMPUTER SYSTEM

Canadian Pension Commission Benefit Delivery System - CPC / BDS. System development began in 1980 as part of the project to develop the Veterans Services Benefit Delivery System (VS / BDS). It is now a separate system. The planned implementation date was mid-1982. It was seriously delayed by the problem of obtaining commitment from all the management areas involved and resolving questions among them of internal jurisdiction and responsibility for the new system. As a result, there were significant problems in defining the system to be developed.

Later in its development, the project was delayed by computer capacity problems in the Department. Then, in late 1983, the system failed completely again because of capacity problems, nine months before the move to Charlottetown and soon after the conversion and implementation were started. The Department hired additional staff to clear the backlog of veterans' pension applications manually.

In spring 1984, the Pensions Branch, which was using the new system, moved from Ottawa to Charlottetown. Several facts contributed to subsequent difficulties: the system's development by external consultants and staff who did not relocate; the lack of documentation for the operational and support of the system; and the need to replace the staff.

When the time came to relocate, 44 of the 47 clerks, and most of the 30 benefit pay clerks needed to process the paperwork, chose not to move to Charlottetown. The system was difficult to operate, and it failed again in the summer of 1984 as a result of processing difficulties, inadequate documentation and the shortage of trained staff.

Major changes were introduced in the CPC / BDS to remove elements that had proved to be unworkable. At the same time, a number of controls were removed to speed up processing, and additional staff were hired to clear the backlog. The backlog was reduced to a manageable level in mid-1985, and the staff level was restored to its original size. No changes have been made to the system since that time.

CPC / BDS, and its related sub-systems, has cost an estimated $4.5 million to date. According to the initial plan, its cost was to be only part of the $2.3 million to be spent on client-oriented systems. The annual processing cost for the system is estimated by the Department at approximately $1.7 million and an undetermined portion of $3.7 million EDP overhead, compared with the $58,000 annual cost predicted at the outset of the project.

In spite of development and ongoing costs that are far greater than anticipated, the system has not achieved two important objectives. First, it has not provided either an automated benefit calculation or a record of veteran payment history. As a result, the process of establishing the veteran's pension amount continues to be labour intensive, and adequate financial trails of veterans' pension payments are not maintained.

Second, no person-year savings have resulted from introducing the system. In fact, its implementation created a need for additional manual effort, much of it paid at overtime rates, to deal with the resulting backlog. The CPC / BDS process comprises a mixture of computerized and manual steps. A significant amount of manual effort is needed strictly for processing paper.

Financial Control

13.109 Because of the relative inexperience of financial staff and the lack of documented procedures and practices for processing disability pension payments, we examined the financial control over the CPC/BDS process. We also carried out tests on a sample of 100 files to determine whether payments were made only to eligible recipients and at the adjudicated amount.

13.110 As we reported in 1980, we again found, after testing disability pension payments during the period from April to October 1985, that payments were made to eligible recipients in the correct amount.

13.111 The financial controls over the systems for placing individuals in a pay status were strong, but there were significant weaknesses and errors in accumulating accounting information for financial reporting purposes.

13.112 The Canadian Pension Commission - Benefit Delivery System provides information for the production of cheques by the Department of Supply and Services and for the Departmental Reporting System, which provides financial reports. There is no reconciliation of the accounting information in the Canadian Pension Commission - Benefit Delivery System to that in the Departmental Reporting System.

13.113 Because of design flaws in CPC/BDS and a general lack of understanding of how the system works, incorrect entries have been made to the Departmental Reporting System. Since this system serves as the information source for the production of the Public Accounts of Canada, the errors are reflected in the Public Accounts. The Department has developed a work plan to resolve this problem by July 1987.

13.114 We found that the financial controls over the accounting for disability pension overpayments were also inadequate. This endangers the ability of the Department to ensure that overpayments are recovered promptly and in the right amounts.

Classification

13.115 We observed that some positions in the Canadian Pension Commission are overclassified. The Department has said it will address overclassification as part of its restructuring of the new Pensions, Health and Social Services Branch.

Health and Social Services

13.116 The Department's role in direct delivery of health care to veterans has declined as a result of a 1963 Cabinet decision to transfer Veterans Affairs institutions to the provinces. In the next 15 years, one of the Department's major challenges will be co-ordinating its role with that of the provinces, and in some instances financially assisting the provision of health care to veterans. The Department is committed to ensuring that veterans with service-related disabilities and low incomes are cared for in all stages of the health care cycle.

13.117 The major vehicle for delivering health care benefits will be the Veterans Independence Program. Eligibility for this program will form the basis for access to most departmental health care benefits. Our audit examined the planning for this program and its delivery.

13.118 One of the principles behind the Department's policy that it will cover only those treatment costs that are not borne by the provinces is that the veteran is entitled to receive the full array of provincial services. To the extent that a service is insured, the insurance scheme will pay the cost, with the Department "topping up" to cover any costs that the scheme does not cover. For example, under the Doctor of Choice program the Department pays the excess portion of an extra-billing doctor's fees, the balance being paid by the province in the usual way. The only exception to this is where the treatment is directly related to a pensionable condition as defined in the Canadian Pension Program, in which case the Department accepts responsibility for the full costs.

The Veterans Independence Program

13.119 The Veterans Independence Program (VIP) began in 1980 as the Aging Veterans Program. The Department realized that as its clients aged, there would be a growing demand for institutional care. In the case of war disability pensioners, the Department was committed to paying the full cost of this care where the need was related to the pensionable condition. If institutional care – where the veteran had to leave his or her home – could be delayed or prevented, considerable economies could be achieved. Under the program, a full social and health assessment is made of eligible veterans in their home setting to determine whether they could be maintained there if minor modifications to the property such as wheelchair ramps or grab rails were made to the property, maintenance services such as snow removal or housekeeping were offered, or in-home health care and some transportation assistance were provided. This could yield significant savings in comparison with institutional costs. The Department estimates the cost of maintaining a veteran in an institution to be in the order of 10 times the cost of maintenance at home under the Veterans Independence Program. Also, the program provides important social benefits to the veteran by delaying the need to break up his or her home and family, which often results from institutionalization.

13.120 The program represents an innovative approach to providing care to an aging segment of the population. Similar programs are being implemented by some provinces to meet the increasingly pressing demands being made on their institutions as a result of the rapidly growing elderly population.

13.121 The Aging Veterans Program was limited to pensioners, and assistance was related to their pensionable condition. In 1983 the program was extended to needy veterans as well, with financial need to be assessed through the income test used for the War Veterans Allowance program. The extensions are to be phased in over four years, beginning in 1985 and ending in 1988 with the inclusion of War Veterans Allowance "near recipients". (This group is defined as those who would be eligible to receive the War Veterans Allowance were it not for the income they receive under the Old Age Security Act.) This is a major extension of the program that will pose a series of planning and administrative problems in the next few years. On the positive side, it brings the delivery and management of the full spectrum of veterans' health care services under a single umbrella program.

13.122 **Planning.** Because of the limited data the Department has on its client population and their needs, planning and forecasting for this program has proven difficult. In 1980, we were critical of the planning and evaluation arrangements for the pilot program leading to the Aging Veterans Program. Exhibit 13.9 compares actual case load and expenditure results with projections in 1983 and 1985. The 1983 projections were used for the proposal to extend the program.

13.123 The 1985 projections are significantly better, reflecting longer experience with the program. However, client numbers are still slightly underestimated. Actual cost figures have so far been fairly accurate, although the Department has used a projected cost per case that is about one and a half times its actual experience. This resulted from higher than expected take-up rates in the west (where costs per case are low) combined with lower take-up in the east (where costs per case are high).

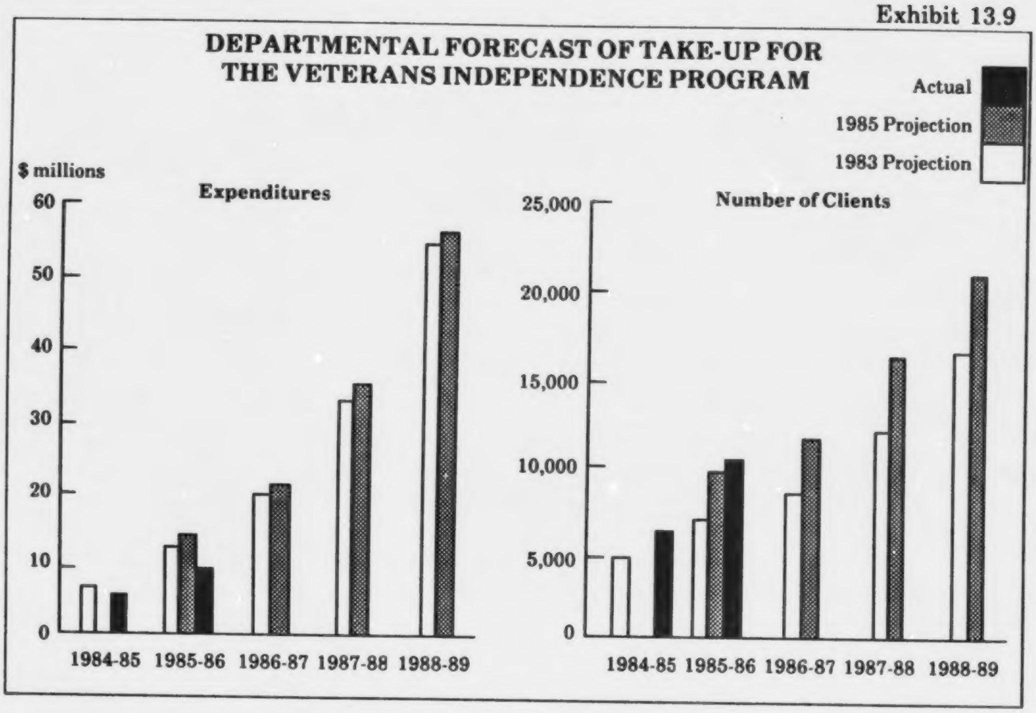
13.124 We are, however, concerned about forecasts for the 1988-89 year and later. The Department has no reliable data on the size or distribution of the near recipient population, in spite of the fact that its future costs and workloads will depend on the size of this group.

13.125 The Department is aware of its problems in forecasting for the Veterans Independence Program and has commissioned the design of a new forecasting model. However, a new model cannot overcome the absence of critical data.

13.126 It should be noted that the costs given for the Veterans Independence Program are only the costs of disbursements made under the program. The assessment and counselling costs, usually involving several hours of professional time for each new veteran served, and the administrative costs of the program are not included. These costs are likely to be significant, but they are not currently known. According to the Department the revision being made to the Operational Planning Framework will facilitate accounting for these costs.

13.127 **Operations.** There are 9,500 veterans currently in receipt of assistance under VIP. Claims for services are often monthly, and the number of claims received by the district offices is very high. Treasury Board requirements make it necessary to process each claim through a complex system of accounts and authorities before it can be paid, whether it is a small claim for snow removal, or a larger claim for home improvements. As the take-up of the program increases, the paper burden will become more significant. The risk to the Department is an overload of district office operations to a degree that will affect the efficiency and effectiveness of program delivery. The Department is fully aware of the dimensions of this problem and is studying possible solutions in conjunction with Treasury Board.

Exhibit 13.9



DEPARTMENTAL FORECAST OF TAKE-UP FOR THE VETERANS INDEPENDENCE PROGRAM

13.128 **Monitoring and evaluation.** In our 1983 audit of program evaluation, we audited the initial evaluation of the Veterans Independence Program. Since then, the Department has finished an evaluation framework for identifying the data needs for monitoring and evaluation, and the program is to be evaluated again in 1988. We consider this to be a reasonable evaluation schedule.

13.129 Although the Deputy Minister approved the evaluation framework in 1984 and instructed that data on the program be collected regularly, no action plan was developed by program management to ensure that this would be done. This means that management may not have all the information it needs to assess critical effectiveness issues. The Veterans Independence Program is a major innovation for the government in meeting its health care obligations to elderly citizens. The limited problem it is dealing with now will become widespread in the general population over the next 20 to 25 years. While the Department must give first priority to program delivery, it also has a very real opportunity to learn lessons that will not only save millions in the Veterans Independence Program but could in future save much more as similar programs are created to serve society on a much wider scale.

13.130 The Program Evaluation Directorate has reviewed the design for the program administration forms. In its view these could, if properly completed, provide a basis for assessing whether the program has succeeded in its objective of delaying veterans' institutionalization. However, the annual review of the data entered on these forms has not been regularly done.

13.131 A management information system has been established in the past year. It relies almost entirely on labour-intensive manual reports, and serves mainly as a basis for classifying and counting outputs. The system does not produce data on outcomes, such as turnaround times, that would allow management to relate the outputs to the achievement of proposed objectives.

Contract Hospitals

13.132 Contract hospitals represent an important way the Department meets its obligation to provide beds for eligible veterans. Under the transfer agreements with the provinces, these institutions have long-term arrangements with the Department to provide blocks of beds (priority access beds) and care to veterans in return for direct reimbursement of related costs. The Department estimates that it will have spent $60 million on these services in 1985-86. It is expected that the demand for institutional care for veterans will accelerate to a peak in about 2000, and will then decline quite rapidly.

13.133 **Audit of payments.** The Ontario region has developed an audit process for auditing the submissions for payment of the portion of contract hospital costs for which the Department is responsible. This has resulted in significant adjustments to the claims submitted by the contract hospitals. In 1983-84, the audit work resulted in a reduction of approximately $220,000 in the claims of just two contract hospitals. An important part of the audit process is the preparation of a memorandum of understanding between a contract hospital and the Department. This outlines the cost allocation for subsequent years to avoid the repeated inclusion of unacceptable costs.

13.134 In our opinion, if the Department adopted this methodology in other regions with similar contract hospital arrangements, it could significantly reduce its contract hospital costs.

13.135 **Bed planning.** For the rest of this century the provision of institutional care for veterans will place a growing demand on departmental and provincial resources. At the time of our audit, several basic questions had not been resolved.

13.136 The Department has not yet established the extent of its liability for provision of institutional care. If it is to plan for the provision of beds it will need to establish this clearly. Specifically, it will need to determine whether eligibility should be restricted to Canadian Pension Commission and War Veterans Allowance recipients or should include all veterans with theatre-of-war experience. These are very different populations with respect to need, ability to pay and size. The inclusion or exclusion of one or more of these groups would have a significant effect on bed requirements. Currently, according to departmental regulations, all three categories are equally eligible for care in priority access beds, although departmental practice gives preference to pensioners and needy veterans when there is a scarcity.

13.137 The Department needs to determine, in the event of a shortage of beds, how the necessary beds will be built or bought. It also needs to know what its part will be in ensuring that there are enough beds for the growing needs of veterans.

13.138 The need for a long-term bed plan to determine the numbers, types and locations of beds that will be needed in the future was identified in the 1983-84 Multi-year Operational Plan. An initial projection of bed demand was provided in that plan.

13.139 Although the Department recognizes the need to co-ordinate these plans with provincial and institutional bed planning, no specific mechanism to do so has been established. Some provincial governments have planning initiatives to provide these beds. At the present time, there are not enough long-term-care beds in the country, and even with construction programs under way, this situation is likely to persist with Canada's rapidly aging population.

13.140 It is our understanding that detailed bed planning work is under way, and that the first stage has been submitted to senior management for review.

13.141 **The Department of Veterans Affairs should determine the categories and numbers of veterans for whom it is obliged to provide institutional care, and plan specifically how it will meet this obligation if there is a shortage of beds.**

> *Management's response: As noted by the Auditor General, detailed bed planning work is under way and the first stage, identification of need, has been completed. This shows that the Department's present number of beds appears not to be sufficient to meet future needs. The second stage, the identification of sources for, and financing of, additional beds is just commencing and will involve extensive discussions with provincial governments.*

St. Anne's Hospital

13.142 This is the largest institution still being run by the Department. It uses over 1,100 person-years and cares for 900 patients. We examined issues related to the extensive use of overtime in the hospital and what seemed to be a very large number of grievances by staff. We found that both situations were being handled in an appropriate manner by management.

Corporate Functions

Financial Management and Control

13.143 We have reported our audit findings on financial management and control for the various programs in the sections on those programs. In addition, there are corporate functions that provide direction to, and tools for, program managers to ensure that they achieve value for money in their activities. We report on these in detail in the following sections.

13.144 Our findings have led us to the view that there are serious weaknesses in basic internal controls and that insufficient emphasis and attention appear to have been given to the financial implications of decisions. The effects of this are compounded by the fact that financial management information, though voluminous, is not regarded by managers as useful or reliable. In addition to the matters reported on in the chapter, many findings of a less significant nature have been discussed with management.

13.145 Management has identified and begun action on many of the specific problems that led to our overall concern about the state of financial management. However, many of these are long standing problems. Management explanations of the reasons why they are only now being addressed range from the view that they have only been seen as problems by current management to the view that, because of the disruption caused by the move, attention and energy were fully devoted to maintaining levels of service to veterans.

Planning

13.146 We reported in 1980 that the state of planning in the Department was a matter of major concern. Following the hearings held by the Public Accounts Committee on our 1980 Chapter, the Committee reported to the House of Commons that "the Auditor General was concerned that the Department's planning process is inadequate. Your Committee shares this concern".

13.147 **Strategic planning.** In 1980 we observed that the Department had not established an adequate strategic planning function. In its response, the Department concurred and stated that steps would be taken to deal with the problem. Some progress was made, and in 1982 a departmental long-range plan was developed. However, it was not regularly maintained and was soon outdated.

13.148 In 1983-84, the Deputy Minister created a new Corporate Planning Directorate, and in the past year progress has been made. Some but not all of the basic elements of a planning infrastructure are now present. At the end of our audit, the remaining infrastructure elements – a planning manual and a planning policy – had been developed as drafts.

13.149 In the past year the Department has taken the first and most difficult step in developing a strategic plan. As the result of a lengthy process involving all of the Department's senior managers, strategic objectives have been established. These have been published in Veterans Affairs' *A Direction for the Future: 1986 - 1991*. This document establishes a basic mission statement for the Department, and sets out six basic objectives to be pursued over the next five years.

13.150 **Long-range planning for key programs.** In its 1981 report, the Public Accounts Committee expressed the following views:

> 15. Your Committee noted that, in most cases, there will be a notable decline in the demand for services of the Department and its associated agencies by the turn of the century. For example, the Veterans' Land Administration (VLA),

under whose provisions lending was terminated in 1977, has a clearly defined "sunset" around the year 2007.

16. Your Committee recommends that the Department and its associated agencies take steps now to plan for the reduction and, in many cases, elimination of programs for which no appreciable clientele will exist within 20 years. Measures to reduce the scale of departmental staff and related expenditures should be particularly well advanced in the case of VLA and programs like it.

13.151 In light of this recommendation, and of the challenges that now face the Department in setting its course for the next 15 years, we would expect that plans running to the end of the century would be well developed. Where appropriate, we would expect plans either for terminating programs or handing them over to other departments when falling case-loads can no longer support the overhead costs for separate program delivery. Of the major programs and functions in the Department, the Veterans Land Administration is the only one for which a long-term plan, setting out declining resource allocations and organizational arrangements in relation to declining workloads, has been developed.

13.152 As discussed in paragraphs 13.81 to 13.86, in the absence of a long-range plan for the War Veterans Allowance, fundamental decisions have not been made on the medium- to long-term administration of the program. Additionally, the Department has yet to develop a long-term plan that identifies the nature and extent of its need for beds and matches that with known supplies. However, work was under way at the time of our audit to develop a plan for bed accommodation. Additionally, studies were in progress at the time of our audit that will provide input to long-term planning for other programs.

13.153 Long-range planning for electronic data processing (EDP) is severely hampered by the absence of long-range plans for key programs. The Department does not own any large computers of its own, and accordingly contracts out for the operation of all its major systems. A decision on its computing direction was required in 1984, when the Department's five-year contract for computer services expired. In the absence of a long-range data processing plan, the decision was postponed in 1984 and again in 1985 by extending the contract. Work on developing a long-range plan began in 1985.

13.154 In part to prepare for re-tendering the contract, EDP planning was begun, without long-range program plans on which to base future computer requirements. The plan was not complete by the end of our audit. Because long-range program decisions had not been made, the resulting tender specifications assumed that the Department's major systems would be enhanced during the five-year contract period, and that these systems would continue to use large batch processing computers. Because of these assumptions, the tender specifications called for a twofold to threefold increase in computer capacity, even though the processing load of existing programs, in particular WVA, is forecast to decrease markedly. The planners were aware, however, that some additional program-related development would be required in areas such as Health Care and management information systems. However, detailed estimates of the system capacity necessary to meet these were not prepared, as the nature and extent of the need was only very generally defined.

13.155 Through the tendering process the Department was able to obtain this increase in computing capacity for $13 million over five years; a cost per unit of capacity that is less than under the old contract.

13.156 In summary, there are currently few long-range plans for the Department's major programs and functions, even though these programs face major changes. Key decisions about how to cope with these changes will have to be made soon if it is to be done in the most economic way. In the view of the Public Accounts Committee, some aspects of this were urgent six years ago.

13.157 **Information for planning.** Our 1980 audit observed that Veterans Affairs had little data on the current characteristics and needs of the veteran client population. At that time the Department assured us that it was examining the potential of conducting surveys to gather the necessary data.

13.158 In 1986, the Department still does not know how many veterans there are – as defined by its various Acts – or what proportion of that population is eligible for the programs it delivers. As noted in paragraph 13.13, it has only very general information on "Census Veterans" from the 1971 Census. It does not know how much of the target population its programs are reaching. As we note in paragraph 13.124, the Department also lacks reliable data on the number of "near recipients" and on the distribution of income in this group; that is those that would receive the War Veterans Allowance were it not for their receipt of Old Age Security/Guaranteed Income Supplement.

13.159 One initiative proposed by the Department that has considerable potential is to use the Old Age Security/Guaranteed Income Supplement program to obtain information on veterans over 65. As the population ages, this will cover an increasing proportion of veterans. Questions would be added to the National Health and Welfare Old Age Security/Guaranteed Income Supplement application form to provide information on the recipients' veteran status. A one-time survey of Old Age Security/Guaranteed Income Supplement recipients through a mail-back card is also proposed. An important opportunity was missed, however, when it was not dealt with before the recent revision of Health and Welfare application form. The Department informs us that it is also looking at the use of Statistics Canada's survey capacity to gather this information.

13.160 The Department is increasing its use of models to estimate future program activity, but as these are based on the 1971 Census definition of "veteran", inaccuracies are being magnified. While we commend the increasing use of forecast models, these are no substitute for reliable planning information. The models are ultimately no better than the data fed into them.

13.161 **Operational planning.** We would expect the annual development process for the operational plan to begin with goals to be achieved by the Department in the coming year. These would be set out in broad but clear terms by the Deputy Minister and would be expressed in increasing detail and become increasingly specific as they move down the levels of management.

13.162 Once goals are established, we would expect them to be ranked in order of priority. In the current climate of restraint, it is likely that there will not be enough resources to meet all goals, and priorities are necessary to ensure that scarce resources are used to meet goals that are critical.

13.163 We found that in the past goals and objectives were often not clear enough to enable managers to measure the costs of achieving them or to determine with certainty whether they had been achieved. However, for the year now in progress, the Deputy Minister has established accountability contracts with each of the Assistant Deputy Ministers. These establish the goals and performance standards to be achieved by each of them in the next year. It is too early to tell how this innovation will work.

13.164 An effective financial planning process should, whenever possible, specify planned results and link these results to resource requirements. This requires clear, measurable goals and objectives and links between them and requests for resources.

13.165 We found that resource requests were not always related to the work to be performed. Were this to be done, it would be possible to allocate resources according to the level of service needed or chosen. As an example, the total number of counsellors required by a region could be determined by the number of veterans in the region, and the workload associated with serving them. Some of this information is gathered as part of the departmental performance measurement system (see paragraph 13.177). However, the work standards are out of date, and hence the information is regarded as unreliable by management and has not been used in resource allocation.

13.166 One result of this is that there has been no basis for ensuring equitable resourcing among the regions. There has been no significant reallocation of resources among regional offices since their creation in 1980. Nonetheless, there are marked, and widening, differences in their workloads. A study by the Department in 1985 showed that a staff member in the Atlantic region is responsible for twice as many clients as a staff member in the Prairie region. In the absence of an ongoing, detailed performance measurement system, it is not clear the extent to which these are efficiency differences or the result of fundamental regional differences.

13.167 As a consequence, the budgetary process is largely incremental, and we found little evidence that the budgets were prepared on the basis of unit cost per approved service. The prevailing view in the Portfolio is that there is very little room to "manage" the program funds. A Portfolio report to Treasury Board indicated that $16 million of the operating cost is considered to be discretionary spending. The rest of the Portfolio's expenditures are regarded as quasi-statutory, or as essential to meeting these quasi-statutory requirements, and hence are of a non-discretionary nature.

13.168 **Budget challenge and review.** As a budget submission moves up the line from the responsibility centre level, it should be fully and rigorously challenged by the next level of management before it is accepted. We would expect such a challenge to include a review of goals and priorities and the achievement indicators proposed in the plan, and an analytical review and challenge of resource requests and their relationship to workloads. While it is expected that the most severe challenges would be directed to cases where the resources to workload ratio appears to have increased, budgets that remain the same should not be passed without review. Indeed, procedures should ensure that all expenditures are challenged on a cyclical basis. Given the importance of budget challenge to management, we would expect that it would be a relatively formal and fully documented process.

13.169 We examined the budget preparation process in the Veterans Service Branch, which accounted for over 80 per cent of the Department's operating expenditures. In the two regions we visited and at headquarters, the review of budget submissions was informal and not documented. We were informed that questions are raised and discussed with the responsibility centres and that this leads to budgetary recommendations. Minutes of meetings were not kept and decisions were not documented, and we could find no working papers to ascertain the depth of any review.

13.170 Budgeting approaches were different among regions, and the differences were not identified by headquarters or the regions. The planning instructions issued by financial and branch management contained no clear guidelines setting out a standard budgeting approach using predicted costs, volumes, etc. The Veterans Services Branch planning group did not know the bases for regional forecasts and did not conduct a review and challenge that requested details of how the forecasts were prepared or, for example, the basis of volume or unit costs of providing the services. For example, the workload to resources variances among the regions noted in paragraphs 13.166 were not picked up in review.

13.171 **The Department of Veterans Affairs should ensure that an adequate budget challenge and review is conducted and documented.**

> *Management's response: Recent initiatives have introduced a challenge process at the Departmental Executive Board level as a regular feature of the budget process. A similar process is taking place within the branches of the Department.*

Monitoring and Evaluation

13.172 In addition to corporate planning and budgeting, an important corporate function is the exercise of operational and strategic control over the activities of the Department. The basis for such control is meaningful information on program performance, and corporate management's control depends on its ability to gather this information promptly. It would include information on a program's consumption of resources, both financial and human, the quantity and quality of the program's outputs and, where possible, information on its effects. On a strategic level, program evaluation should provide managers with indepth information on program effects (information that would often be uneconomic to gather on an ongoing basis), so they can make fundamental decisions on matters such as program structure and the relation of the program to current client needs. Accordingly, we examined the Department's information systems with respect to finances, personnel and performance. We also looked at the program evaluation function in the Department.

13.173 **Financial management information.** The Department does not have an integrated financial management information system that compares actual to budgeted expenditures on a timely basis, or provides up-to-date information on free balances. Managers have developed their own systems to maintain control over their budgets. There are thus a variety of uncoordinated systems in many responsibility centres that need to be reconciled with the formal systems. There is no assurance that this is done regularly and no assurance that their data agrees with the formal systems.

13.174 The Department receives over 60,000 pages of financial reports monthly from the Department of Supply and Services, and the Benefit Delivery Systems produce over 200,000 pages in the same period. Of the reports that are used, most are in a format that makes interpretation and analysis difficult. Many have to be manipulated and reformatted to make them acceptable to departmental managers. A comprehensive needs analysis and distribution study to assess the usefulness of these reports has not been done for a number of years.

13.175 The Department has recognized these problems. It is developing an automated financial management system capability to improve its use of the departmental reporting system and to replace labour-intensive manual systems. It has also initiated a major project to develop a classification of accounts and a financial information system that will provide management with appropriate information on both organizational and program lines.

13.176 **Personnel management information.** The personnel information system now in place in the Department does not provide timely information to managers and is not regarded by them as a credible source of information on matters such as training and secondments. These are serious shortcomings in a labour-intensive organization. We were informed that plans are being developed to remedy the problems with the personnel management information system.

13.177 **Performance measurement.** In 1980, we reported that the departmental efficiency performance measurement system was out of date but was being redesigned. It has since been completed and implemented nationally at an annual cost exceeding $500,000. However, management has never been satisfied with the reliability of the information, and there is little evidence of much use having been made of it. For example, performance standards were developed in 1982 in one region but not validated. In 1985 the Department stopped calculating efficiency indices because the performance standards were out of date. It is now used only as a source of information on outputs (for example, on the number of hearing aids dispensed).

13.178 During our audit, the Department began redesigning the system with the goal of having the new system operational by 1987-88. The work completed by the end of our audit appeared satisfactory, although none of the project products had yet been issued.

13.179 We found that insufficient information on quality of service was being gathered on the Portfolio's programs. The information gathered on client satisfaction and processing times was not adequate, and what was being gathered was unreliable.

13.180 The Portfolio relies on analysis of client mail and representations from veterans' organizations to monitor client satisfaction with the Portfolio's services. While these provide important feedback of a general nature, they do not provide systematic information on specific elements of the services. A comprehensive survey of client satisfaction was done in 1980, but we found little evidence that the results were used and it was never repeated.

13.181 Management at all levels of the organization told us that the time taken to deliver programs to veterans was the key indicator used to monitor operations. In several areas, managers are required to provide written explanations whenever their operations exceed pre-set processing time standards. However, we found that measurements of the most important processing times were inaccurate. This was generally due to a failure to ensure that various organizational units calculated times uniformly. The Department had no quality control mechanism to ensure that measurements were accurate or consistent. For example, the Department reported that the average War Veterans Allowance application during 1985-86 was processed in 28.9 days. Our audit sample estimated that the time was approximately 42 days. One cause of the understatement was the practice in one regional office of arbitrarily assigning rejected applications a processing time of one day. In fact, these generally require the same time as approved applications.

13.182 The Department does not know with any certainty the number of person-years used in delivering programs such as the War Veterans Allowance Program or the Veterans Independence Program. As a result, it cannot make precise estimates of the person-year savings to be made through innovations in a particular program. When changes are made, it does not know whether the intended economies have been achieved.

13.183 The Department makes substantial use of overtime to meet a variety of needs including seasonal surges in workloads. Information is available on hours of paid overtime but not on cases where the employee elects additional leave in lieu of overtime payment. Although reliable information was not available through the Central Leave Reporting System, a conservative estimate of the total amount of leave taken in lieu of overtime by Department of Veterans Affairs employees in 1984-85 was 100,000 hours, or the equivalent of about 50 person-years. Overtime paid was equivalent to about 100 person-years.

13.184 This represents a significant expenditure of resources by the Department. Much of the overtime arises from operations at St. Anne's Hospital where, as noted previously, we observed that it was adequately documented and controlled. However, the fact that reliable and timely data are not available for the remaining departmental programs raises concerns about the accuracy of the Department's information on the costs of program delivery and about the extent to which the use of overtime is being managed and controlled.

13.185 **Program evaluation.** In our 1983 government-wide audit of program evaluation we noted substantial progress in the conduct of effectiveness evaluations since 1980. Management processes were in place and satisfactory effectiveness evaluations had been produced. However, implementation of evaluation recommendations was not being monitored systematically.

13.186 The Portfolio has now developed a monitoring system and has evaluated a substantial portion of its programs. We found evidence that evaluation results have been used. For example, a 1983 evaluation of the Department's drug programs led to increasing use of private sector drug plans to deliver the program. The most recently completed evaluation, that of the Bureau of Pensions Advocates, provided extensive data on many key aspects of the Bureau's operations, including data on client satisfaction, and the Bureau has begun to act on many of the recommendations in the report.

13.187 The evaluation function has continued to make significant progress. Since 1980, it has served as the Portfolio's principal means of assessing program effectiveness, and has covered its major programs.

13.188 **Accountability to Parliament.** The Portfolio provides information to Parliament in its annual report and in Part III of the Estimates. We examined this information to determine whether it was accurate and complete enough to provide a comprehensive picture of the Portfolio's financial and operational performance.

13.189 Both documents conform to government guidelines and provide an initial basis for parliamentary review. Improvements have been made in the reports every year. However, there were significant inaccuracies in some of the information provided, and insufficient performance information for some programs, notably the Department's health programs. It would be difficult, where this is the case, for Members of Parliament to determine whether value had been received for the money voted. The Portfolio informs us that more performance information will be provided when new performance measurement systems are completed.

13.190 We concluded that the Portfolio has not paid enough attention to ensuring the correctness of its accountability reports. Most of the inaccuracies resulted from inaccuracies in the Portfolio's internal information systems. Quality control mechanisms are inadequate to ensure that information reported internally and externally is correct. As a result, as we note in paragraph 13.181, information on processing times was substantially understated for the War Veterans Allowance program. Similarly, the Canadian Pension Commission reports average processing times for 1984-85 disability pension applications through all levels of the Canadian Pension Commission that are approximately half the actual times recorded during this period. As noted in paragraph 13.68, program costs reported for War Veterans Allowance operations are 50 per cent higher than actual costs, and correspondingly, Health Care costs were understated by the same amount.

13.191 The Portfolio reported the findings of the Bureau of Pensions Advocates program evaluation in Part III of the Estimates. The evaluation measured whether case preparation was satisfactory and gathered information on clients' satisfaction with the Bureau's efforts. Such reporting serves to inform Members of Parliament about program effectiveness. However, we found that the reporting of the evaluation somewhat overstated the evaluation's generally positive conclusions. The Portfolio reported that "a case study of recently submitted cases revealed that the Bureau is meeting its objective of ensuring the highest possible level of entitlement and assessment through the quality of its representation of clients". In fact, the evaluation concluded that the Bureau was meeting this objective "for the most part" and listed several areas where improvements in effectiveness were required. These qualifications were omitted in the Part III Estimates report. As well, the evaluation did not, nor could it, actually measure whether the "highest possible level of entitlement and assessment" was achieved.

13.192 The Veterans Affairs Portfolio should devote greater attention to ensuring that the accountability information in Part III of the Estimates and its annual report to Parliament is accurate and consistent and that reasonable performance information is presented.

> *Management's response: The proposed new Operational Planning Framework and Performance Measurement Systems, combined with changes to the internal reporting process, should ensure that all information is accurate and consistent.*

SPECIAL AUDITS

SPECIAL AUDITS

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SPECIAL AUDITS

Introduction

14.1 Much of the Audit Office's work concentrates on comprehensive audits of departments or government-wide audits. Over the past several years, however, the Office has begun to conduct "special" audits of specific programs or activities that would not be addressed by comprehensive or government-wide examinations.

14.2 During the last year, the responsibility for these special audits was consolidated and provision was made for the results of the work to be reported in one chapter.

14.3 The Special Audits group has been given the mandate to examine specific programs or activities within a department or across several departments. Normally, the audits will address matters that would not be audited on a regular basis, but that are important nevertheless. This approach will increase the efficiency and effectiveness of the Audit Office and at the same time allow the results of work to be reported to Parliament as quickly as possible.

14.4 This year's chapter contains reports on:

- 11 capital projects involving proposed expenditure of $1.3 billion;
- the management of government publications distributed free of charge to the public;
- Department of Energy Mines and Resources - Management of the Public Communications Function;
- the Social Sciences and Humanities Research Council; and
- the Canada Oil and Gas Lands Administration.

Capital Projects

Overview

14.5 Capital projects for the 1985-86 fiscal year amounted to about $4 billion. They have doubled in cost since 1978. These expenditures cover a broad range of equipment, building and land acquisitions. This year we examined 11 projects with proposed expenditures of $1.3 billion. We selected them on the basis of total budgeted cost and because they were representative of ongoing programs in the planning or implementation stage that might benefit from our findings.

Audit Scope

14.6 We examined each project using methodology and criteria developed by the Office of the Auditor General and agreed to by the departments concerned. We assessed each project from the time departments identified the need for equipment or a construction project to the point the project had progressed at the time of our audit.

14.7 We placed special emphasis on departmental processes used to develop plans for capital projects and the methods used to manage capital projects. We attempted to determine the relationship between projects and departmental plans, with particular reference to the strategies for achieving program objectives.

14.8 We examined the project management systems in use to ensure that they complied with existing regulations and to assess the extent to which they met the criteria.

14.9 We also looked at contracts to assess whether the departments and service agencies (Department of Supply and Services and Department of Public Works) had followed departmental and Treasury Board direction in developing contractual arrangements applicable to each project.

14.10 Depending on the state of completion of a particular project, we studied the commissioning phase, which is the process by which the equipment or construction is turned over to the Crown, to assess whether the department received the equipment or building as contracted.

Audit Findings

14.11 **Planning.** On average, in the projects we examined, the planning process took a very long time – as much as 10 to 15 years in some cases. Delays between the initial concept of the project and project implementation - such as the group of projects begun in 1969 which were amalgamated in 1981 to form the Radar Modernization Project in Transport Canada and the Guy Favreau construction project of Public Works - almost inevitably result in an increase in project scope and cost.

14.12 **Needs definition.** The need for some projects was not well defined. In the case of the Guy Favreau project in Montreal, a need for office space was established without clearly identifying space requirements.

14.13 **Project definition.** Projects tended to expand in size as they became more clearly defined. In the case of the Transport Canada's Radar Modernization Project, this expansion resulted in a group of related projects originally estimated at $46 million in 1978 growing into the Radar Modernization Project at a cost of $811 million in 1985. Technical improvements and inflation accounted for some of this change, but a significant portion of the cost increase came from including additional equipment installations that were not fully justified.

14.14 **Options analysis.** All viable options were not fully investigated in all projects. Options such as Crown construction rather than lease-purchase and a reduced deployment of equipment to meet minimal departmental requirements were not developed fully. Thus decision makers did not have all the alternatives for a particular project presented to them.

14.15 **Design.** Departments did well in contracting for conceptual and detailed design. The only problem we found in this area related to hiring consultants without specific authority, requiring Treasury Board approval after the fact.

14.16 **Procurement.** Departments also managed the procurement phase satisfactorily.

14.17 **Reporting to Parliament.** The lease-purchase costs of the Guy Favreau project were aggregated with other leases so that the total cost of the project was not readily identifiable. While this procedure was in accordance with government reporting policy at the time, it did not disclose the total cost of the project.

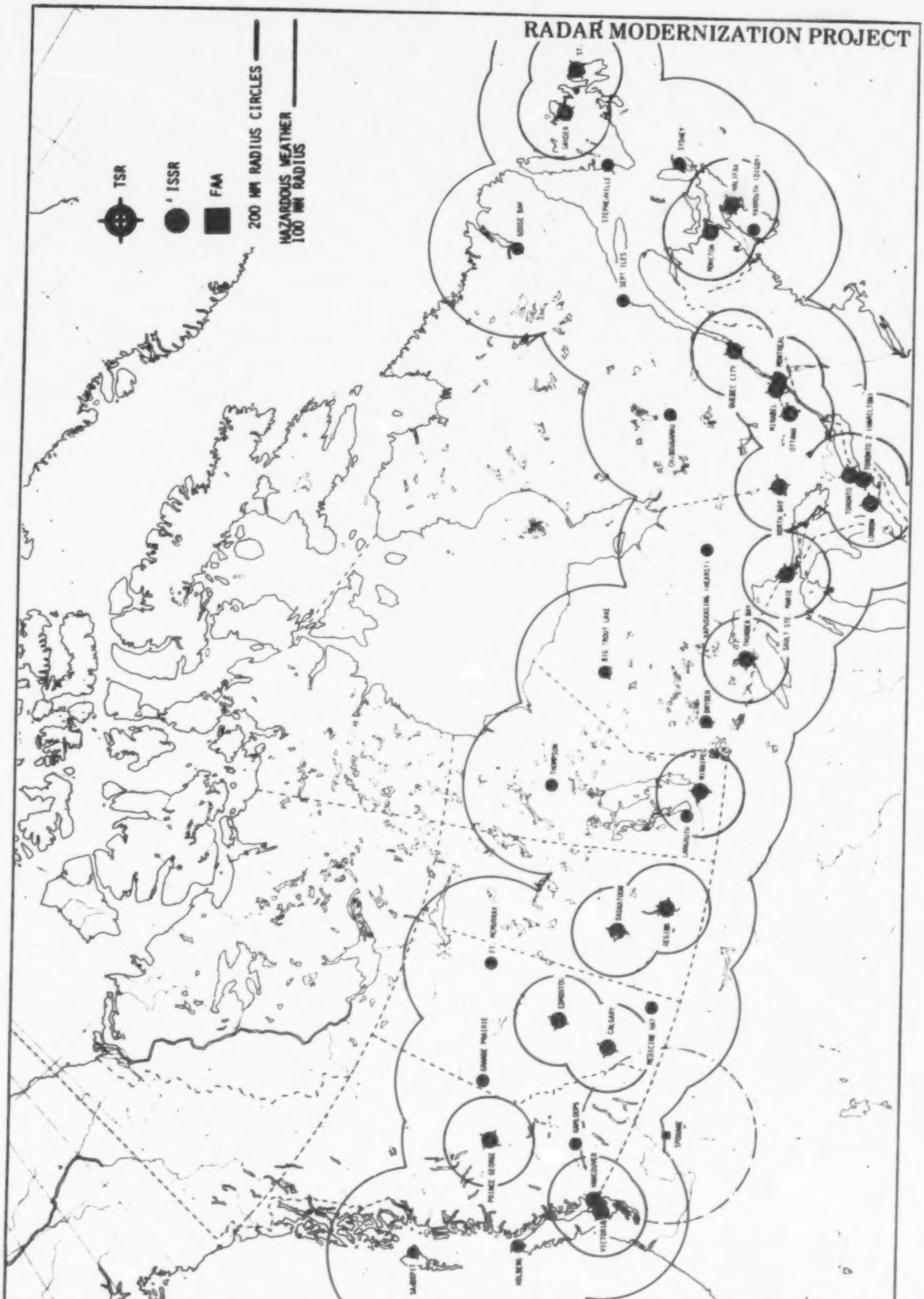
14.18 Following are case studies that illustrate our findings.

Case Study l. The Radar Modernization Project (RAMP)

14.19 In June 1983, Treasury Board approved $811 million to procure 24 new Terminal Surveillance Radar systems and 17 new Independent Secondary Surveillance Radar systems, as well as associated equipment to modernize the existing radar and procedural systems used to control air traffic in Canada.

14.20 **Air traffic control in Canada.** The control of air traffic operating under instrument flight rules at airports and enroute is achieved either by procedural methods or by the use of radar. Prior to the invention of radar, all air traffic control was procedural. Since then, there has been a mixture of radar and procedural systems, with radar being used primarily in areas of dense traffic where the benefits of this expensive equipment justify the cost of installation and operation.

14.21 In both methods, a safe buffer zone is maintained around aircraft in flight by controlling clearances to proceed or change altitude. In the procedural system, the controller cannot see the aircraft and must rely on the pilot's reports of the aircraft's altitude or position relative to a ground-based navigation aid. This is cumbersome and therefore the number of aircraft that can be cleared through a given airspace at a given level of safety in a given period of time is smaller than can be achieved with radar. In a radar system, the controller can see the radar returns of the aircraft and can therefore achieve the desired safety level with a smaller buffer zone. In areas of dense traffic, this can result in more efficient traffic flow.


TSR
ISSR
FAA
200 NM RADIUS CIRCLES
HAZARDOUS WEATHER 100 NM RADIUS
ST.
GANDER
STEPHENVILLE
GOOSE BAY
SYDNEY
HALIFAX
YARMOUTH (DIGBY)
MONCTON
SEPT ILES
QUEBEC CITY
MONTREAL
MIRABEL
OTTAWA
CHIBOUGAMAU
TORONTO 2 (HAMILTON)
TORONTO
LONDON
NORTH BAY
KAPUSKASING (HEARST)
SAULT STE. MARIE
THUNDER BAY
BIG TROUT LAKE
DRYDEN
THOMPSON
WINNIPEG
LANGRUTH
SASKATOON
REGINA
FT. MCMURRAY
EDMONTON
CALGARY
MEDICINE HAT
GRANDE PRAIRIE
KAMLOOPS
SPOKANE
PRINCE GEORGE
VANCOUVER
VICTORIA
HOLBERG
SANDSPIT

RADAR MODERNIZATION PROJECT

$811 million approved in 1983 for new radar systems across Canada (see paragraph 14.19).

14.22 In general, the change from procedural control to radar control at an airport becomes cost-effective once a certain threshold is reached in the volume of traffic operating under instrument flight rules (IFR); that is, without visual reference to the ground or to other aircraft. The number of days in the year when the weather conditions at a particular airport are sufficiently adverse to require flying by instrument rather than visual flight rules is also a factor. Because of this, it is easy to justify procuring the relatively more expensive radar capability at airports with high levels of IFR traffic. The benefits exceed the costs by a significant margin, regardless of differences in weather conditions. At medium and low IFR traffic airports, however, the traffic levels and the prevailing weather conditions may be such that procedural methods may be more cost-effective at any desired level of safety.

14.23 **The background of RAMP.** Air traffic control radars tend to be divided into two types. Those used for the terminal area control of arriving and departing aircraft are called Terminal Surveillance Radars. Those used in the enroute system for aircraft flying at cruising level from point to point are called Secondary Surveillance Radars or Independent Secondary Surveillance Radars. Information from the Terminal Surveillance Radars can be used to assist the other two radars in the enroute network. Our examination dealt primarily with the Terminal Surveillance Radars at individual airports.

14.24 The basic radar equipment for air traffic services in Canada was installed between 1958 and 1961. Between 1961 and 1983 the system was upgraded with the addition of Secondary Surveillance Radars, some newer Terminal Surveillance Radars and a data processing and display system called JETS – the Joint Enroute Terminal System. During this period over 100 modifications were made to the original radars to maintain or improve capability. When the radar modernization project finally came before Treasury Board in 1981, action to replace existing equipment was long overdue. However, the proposed program also contained extensive expansion of the system then in place.

14.25 **Audit approach.** We concentrated on the planning phase of RAMP and on the fact that Transport Canada based its project justification on a benefit-cost analysis. Transport Canada used the benchmark that if the expected benefits of the project do not equal or exceed the cost during its life there is no sound economic basis for the project. We examined the benefit-cost analyses for a selected number of sites to assess whether they met this criterion and whether the assumptions were reasonable.

14.26 **Needs definition.** The need to replace the aging radars was first identified in 1969 by the telecommunications and air traffic control specialists in Transport Canada. They initiated a succession of replacement projects over more than a decade that contributed to and were incorporated into the RAMP project in 1981. The Departments estimated cost of these projects rose from $46 million in 1978 to $579 million (constant dollars) in 1983 ($811 million current dollars) (see Exhibit 14.1). Of this increase, $232 million can be attributed to inflation. From 1978 to 1983, the project was sustained through many changes, but there was no adequate statement of the operational requirements during this period of project development and thus no means of assessing the justification for selected installations. Such requirements would normally have been prepared by the Transport Canada Branches responsible for determining the needs of the consumers of aviation services. This first stage in life-cycle planning would have provided the information essential to determining how much radar capability was required to meet safety and efficiency needs.

Exhibit 14.1

SCHEDULE OF COST CHANGES 1978-1984 FOR RADAR MODERNIZATION
(millions of dollars)

	Pre-RAMP Changes			Changes after establishing the RAMP Office		
	1978*	1980*	1981*	1982*	1983*	1984
Radar Sites	$35	$ 88	$163	$310	$384	$494
Display Sites	5	11	24	66	111	147
Logistic Support	2	2	3	5	22	34
Depot Spares	-	4	5	10	5	7
DSS Fee (7)	-	-	3	5	7	12
Contingency	4	8	15	29	50	117
Total	$46	$113	$213	$425	$579	$811
	(1)	(2)	(3)	(4)	(5)	(6)

(1) New electronics and other modification Program Approval Document.
(2) New Terminal Surveillance antennas and changes to the Secondary Surveillance Radars.
(3) Revised performance requirements.
(4) Joint Enroute Terminal Systems, replacing DND radar sites, and performance changes.
(5) Better defined technical requirements.
(6) Inflationary increases only.
(7) DSS cost-recovery fee.

*constant dollars

Source: Transport Canada records.

14.27 **Options analysis.** We examined the options studied by Transport Canada to determine whether the Department had reviewed the major technical options available for RAMP. We concluded that the Department examined a wide range of technical solutions before reaching a final decision.

14.28 **Project definition.** Transport Canada failed to observe accepted life-cycle management techniques for RAMP. The project developed in reverse. The technical requirement and system plans were developed by the Department and approved by Treasury Board before the Department decided to produce the operational requirement study. This study contains economic rationale for the size and complexity of the project and for siting individual components. The result of doing things in reverse was a study that served to justify the number of new radars already requested rather than an analysis of the minimum operational requirements for new radars.

14.29 When the operational requirement was produced, Transport Canada justified the project by comparing the dollar value of the expected benefits with the costs of each potential Terminal Surveillance Radar installation to determine the final number and location of airport sites to be developed. However, this document was not available in its final version until August 1983, two years after approval in principle for the project had been given, and two months after the final departmental submission had been approved by Treasury Board.

14.30 **Project management.** Since the inception of the project office following formal approval of the project, RAMP has been adequately managed. The contract developed by the project office and DSS staff was complete, and provided substantial industrial benefits to Canadian industry.

14.31 **Benefit-cost analysis.** Transport Canada overstated the expected economic benefits of RAMP in its benefit-cost analysis. The failure to adopt good life-cycle management techniques and to produce a precise, approved operational requirement and level of required service before developing the technical approach, rather than at the end when the project was fully developed, contributed to this overstatement of benefits.

14.32 The overstatement of benefits affected mainly those sites where the expected benefits barely exceeded the costs over the life cycle of the equipment, and particularly where these benefits were based on an optimistic forecast of the volume of instrument flight rules traffic. At these sites, even limited reductions in benefits affect the benefit-cost relationship to the extent that the development of equipment for these specific locations cannot be justified. For example, a 1 per cent decline in expected traffic growth rates produces a 10 per cent decline in expected benefits.

14.33 In our view, at least 3 of the 24 Terminal Surveillance Radars sites have not qualified for inclusion in the proposal, based on Transport Canada's benchmarks. Had the Department's benefit-cost analyses been based on correct data and variables, these three sites – at an average cost of $13.2 million each – would not have been included in the original project. As a result, the estimated cost of the project would have been lower by as much as $39.6 million.

14.34 Rather than ranking all competing projects in the Department, Transport Canada ranked individual components of the project (radar sites) on the basis of benefit-cost analysis of each component, leading eventually to substantiating the project development at the level requested. The Department did not indicate to Treasury Board how sensitive the results of these analyses were to minor changes in forecast data. There was a tendency to use overly optimistic forecasts of aviation traffic growth to support the proposed project, even though actual traffic levels were declining sharply.

14.35 Transport Canada should examine its benefit-cost approach with a view to using benefit-cost analysis to rank all its competing projects in order of priority. All risks and limitations of the analysis should be clearly stated in project documents.

14.36 Transport Canada should ensure that a clearly justified operational requirement is established prior to proceeding with the technical requirement and system plans.

Case Study 2: The Guy Favreau Complex, Montreal, Quebec

The Guy Favreau complex: the office towers are shown in the foreground, the residential component on the right, and the heritage buildings in the right background (see paragraphs 14.37 to 14.62).

14.37 **Introduction.** The Guy Favreau Complex is a major construction project that Public Works Canada has undertaken in downtown Montreal. The concept for the project was first identified in 1966. Over the next 12 years, the type of project, its specifications, scope and cost varied dramatically compared to what had been planned. The project's main components, as defined in 1978 and constructed, are:

- 2 office towers to accommodate 28 federal departments and agencies with a staff of 3,000;
- 4 residential buildings comprising 316 housing units;
- 3 heritage buildings; and
- a podium (the base on which the complex is built) with a government information centre, public spaces, retail outlets, parking facilities and a tunnel to link with the Desjardins Complex.

14.38 We found deficiencies in planning and in reporting to Parliament. The project began with an office tower of 93,000 square metres at a cost of $38.5 million; it expanded to a $200 million project with 250,000 square metres. In the end, it was built as a combined office/housing/heritage project costing $190 million.

14.39 **Audit scope.** We reviewed the need for the project, options considered, project definition and project management. We also examined costing procedures and reporting of projected and actual costs related to the project.

14.40 **Background.** In 1966, The Department of Public Works (DPW) reported that a general shortage of space in federal buildings in Montreal and the high cost of leased accommodation made expansion and consolidation requirements difficult to meet satisfactorily and economically. Approval in principle was given in the same year to consolidating federal government employees in the Montreal core area in a single office complex.

14.41 Following approval in principle, the overall planning for this project was adversely affected by changes of Government, Ministers and senior executives of the Department. These disruptions resulted in a number of policy changes relating to lease-purchase, growth rates in the public service and decentralization that created an unstable situation while the project was in the planning stages. In addition, there were real estate market changes, particularly in the availability of rental space in the Montreal area that had negative effects on departmental plans.

14.42 Until 1972, DPW negotiated with a co-operative, which was considering developing commercial and office space in Montreal, for a combined development. These negotiations broke down when agreement could not be reached on cost-sharing and decision-making responsibility and when DPW decided on a space requirement that exceeded the space available at the proposed site. During the next four years, DPW staff continued to study its space requirements. Consultants continued work on a conceptual design for the building.

14.43 In 1976, the original concept, based on space requirements, was changed as a result of reduced demand for office space in Montreal and because people in the area were opposed to the consolidation plan and to the density of the proposed design. The more important need was then perceived to be the establishment of a strong federal presence in Montreal. This continued to be the focus of the proposed construction.

14.44 Construction began on the podium in 1978. Construction stopped in 1979 and was resumed in 1980. In September 1983, government employees began to occupy the office towers as each floor was completed. Full occupancy is expected to be completed in 1986.

14.45 **Needs and requirements definition.** Throughout the planning phase, DPW did not have in place processes that could clearly define the need for this project. DPW did not establish criteria for the required level of consolidation to be accomplished. The Department conducted a number of studies to analyse space required; however, these studies did not indicate the reason for selecting leases to be terminated or buildings to be replaced in relation to the total requirement. For example, an existing building at 715 Peel Street in Montreal was cited in 1978 by the Department as one option for providing the additional space required to house government employees.

14.46 In 1976, when the objective of establishing a strong federal presence in Montreal became the perceived need, there was still no clear definition of requirements. The space requirement for the project fluctuated significantly during the planning period. Exhibit 14.2 illustrates the changes.

14.47 The issue of the residential component was an important factor in defining requirements. From 1978 to 1981, Canada Mortgage and Housing Corporation consistently advised against including residential components in the complex. DPW studies in 1978 and 1979, and an update in 1980, concluded that DPW would benefit from replacing the residential components with more office space. We did not find any studies or analyses that supported including a residential component in this project. We were informed by the Department that the decision to include the residential buildings occurred as a result of external direction. The Department leased the air space over the podium for the four residential buildings for one dollar each.

14.48 During the period when the residential question was under study, DPW also examined the possibility of using the building at 715 Peel Street to provide the additional space needed to meet the original need to consolidate government operations in Montreal. There was no indication that this possibility made any difference to the scope of the Guy Favreau Complex.

14.49 **Options analysis.** In 1979, the Department hired consultants to prepare a benefit-cost analysis. They presented 15 options, among them:

- The most economical option, as far as the consultants were concerned was to cancel plans for the Guy Favreau complex, sell the building at 715 Peel Street, and use available commercial space to satisfy current and anticipated needs. The consultants calculated that this option would result in a surplus of $18.7 million, based on an annual savings of $2 million when compared with the option of maintaining the status quo.

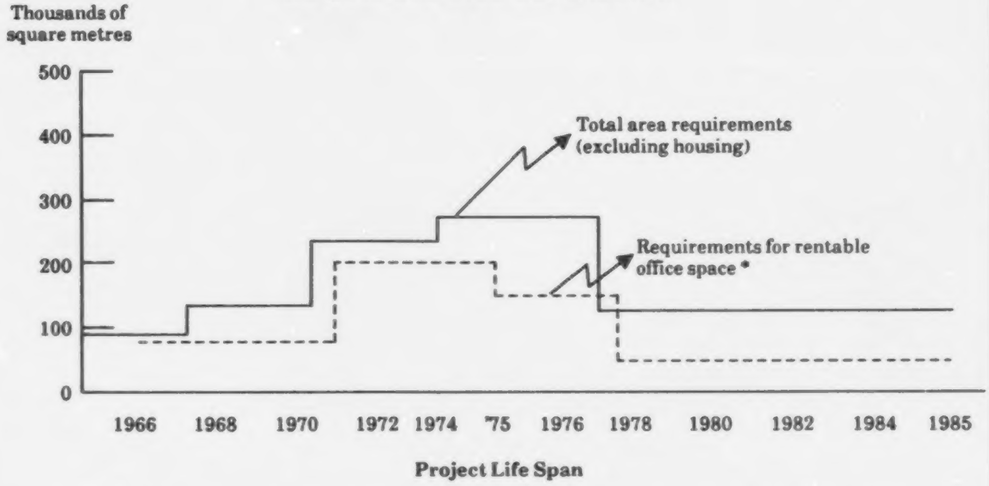
- The least costly option, which still permitted construction of the Guy Favreau Complex, was Crown construction and ownership, with additional office space rather than residential construction. This option also called for the sale of 715 Peel Street. In this proposal, the consultants calculated a net deficit of $23 million based on an annual deficit of $2.5 million.

14.50 The course of action recommended by DPW and selected for implementation ranked 14th in the list of 15 options presented by the consultants. It consisted of developing the Guy Favreau Complex, including a housing component and a lease-purchase of the office towers. In the benefit-cost analysis for this approach, the consultants calculated a deficit of $4.6 million annually for a total of $43 million. According to the Department, the decision to proceed with the option was based on factors other than the benefit-cost analysis.

14.51 The selection of lease-purchase of the office towers was not financially supportable on the basis of the consultants' benefit-cost analysis. DPW's Realty Strategy

Exhibit 14.2

GUY FAVREAU COMPLEX
REQUIREMENTS DEFINITION



* The 1978 requirement was for replacement of 92,000 square metres of leased accommodation. Approximately 40% was expected to be provided at the 715 Peel Street Building, and 60% at the Guy Favreau Complex.

Committee indicated in 1978 and 1979 that "the only reason for choosing the lease-purchase option would be the lack of liquidity of funds and the reduction of (DPW) investment budgets."

14.52 **Project definition.** Because of uncertainties regarding space requirements and the components of the project – residential or office space, the method of financing, and Crown construction or lease-purchase – it became difficult for the Department to proceed with defining the project. This is the step when the specifics of the size, components and initial costing are determined. For example, in 1976 DPW received authorization to enter into contracts with architects and main consultants for detailed design. At the same time, the Department recommended deferral of construction until a time more favourable for the Montreal construction industry. Despite this deferral, consultants were retained in December 1976 at $50,000 a month for at least six months during the postponement while the project was being reappraised by the Cabinet Committee on Government Operations. DPW has stated that the consultants were retained to assist in the reappraisal process. By August 1977, $2.9 million had been spent to develop concepts for which DPW received little or no benefit because of major changes in needs and space requirements. The Department made adjustments to its consultant contract procedures in 1984.

14.53 **Contracting for design.** In December 1971, DPW started selection procedures for consulting services. In October 1973, Treasury Board authorized DPW to contract with architects and consulting engineers to develop the concept. Consultants started detailed design work before Treasury Board approved their contracts. In 1972, the

Department estimated $900,000 for conceptual design. In November 1974, the cost increased to $1.68 million; it went to $2.24 million in 1975. These increases, which finally totalled $2.9 million, were the result of changes in the project definition, the study of requirements, acquisition financing and other revisions to the original concept.

14.54 **Detailed design and construction.** DPW sought final authority to construct the project in 1981. It presented detailed objectives, work packages, schedule, budget, organization and controls. At the time of Treasury Board approval, detailed design was almost complete. The only significant problem was the level of noise from the heating, ventilation and air conditioning system; it exceeded accepted standards. Potential problems concerning noise levels were raised before the contractor started installation. Some modifications were undertaken on a site mock-up system to meet the prescribed standards. These modifications were not incorporated into the installation proper until the building was occupied.

14.55 **Reporting to Parliament.** Amounts in the Estimates on the total cost of the project were misleading since they were often well below the costs projected by the Department and less than the amounts actually approved by Treasury Board. For example, in 1975-76, 1976-77 and 1977-78, the Estimates indicated project costs of $13 million, $13 million, and $17 million respectively. The Estimates stated that these costs were for feasibility study, preliminary design and acquisition of land. During the same period, internal documents and Treasury Board approval indicated an estimated total project cost of over $200 million. In 1981-82, the Estimates showed a project cost of $44 million; Treasury Board approval in 1978 showed a cost of $100 million. Exhibit 14.3 illustrates this situation.

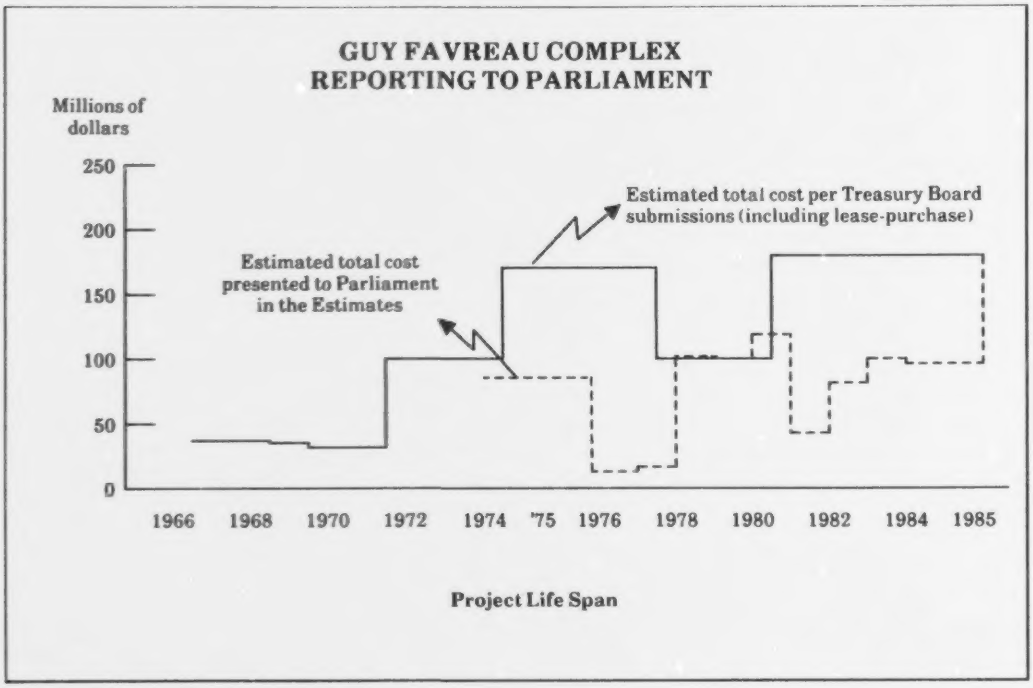
14.56 The annual rental payment of approximately $11 million for the next 35 years under the lease-purchase arrangements was an element of the cost of the project. This was first disclosed to Parliament in 1985. Reporting to Parliament in this case was in accordance with Government policy at the time.

14.57 **Financial summary of costs.** Here are total costs of the Guy Favreau Complex:

	(1986 Estimates) ($ millions)
Capital costs	$ 102.2
Present value of payments under the lease-purchase agreement	87.9
Total	$ 190.1

14.58 The total cost does not include $27 million required to renovate the 715 Peel Street building to provide additional office space. This expenditure would not have been necessary had the residential component of the Guy Favreau Complex been replaced by additional office space in support of the original consolidation objective.

Exhibit 14.3



GUY FAVREAU COMPLEX
REPORTING TO PARLIAMENT

14.59 At present there are approximately 210,000 square metres of space provided in federal buildings and leased accommodation in downtown Montreal; 55,000 square metres are available in the Guy Favreau Complex and 40,000 square metres will be provided at 715 Peel Street. The Guy Favreau Complex provides only 25 per cent of the space required to satisfy the original consolidation concept.

14.60 The Department listed a number of costs for the purposes of establishing the rentals charged to clients and of comparing the results of the departmental feasibility study with those of similar projects. These costs, amounting to $10 million, were largely non-productive:

	(Millions)
Consultants contracts prior to August 1977	$ 2.9
Cost of the site repairs and inspection fees following 1980 work interruption	.3
Housing costs attributable to CMHC and additional costs due to project modification	4.5
Under-use of site	2.3
	$ 10.0

14.61 We estimated at $8 million the present value of the total excess interest payments over the 35-year term. This represents the rate of interest for the lease-purchase compared to the average yield of Government of Canada marketable bonds.

14.62 **Departmental changes.** The Department has made a number of changes to its project management techniques since the Guy Favreau Complex was constructed, including a Project Delivery System and a Real Estate Investment analysis system. We intend to follow up in later audit work to evaluate the impact of these improvements.

Case Study 3. Department of Fisheries and Oceans - Vessel Acquisition

14.63 **Introduction.** The activities of the Department of Fisheries and Oceans (DFO) involve fisheries management, fisheries research, hydrography, and oceanography. DFO operates a fleet of vessels ranging from small boats to large ocean-going ships. The fleet is divided into three separate groups dedicated to fisheries research, fisheries management, and to ocean science and surveys. Emphasis is placed on procuring ships that can perform a variety of tasks.

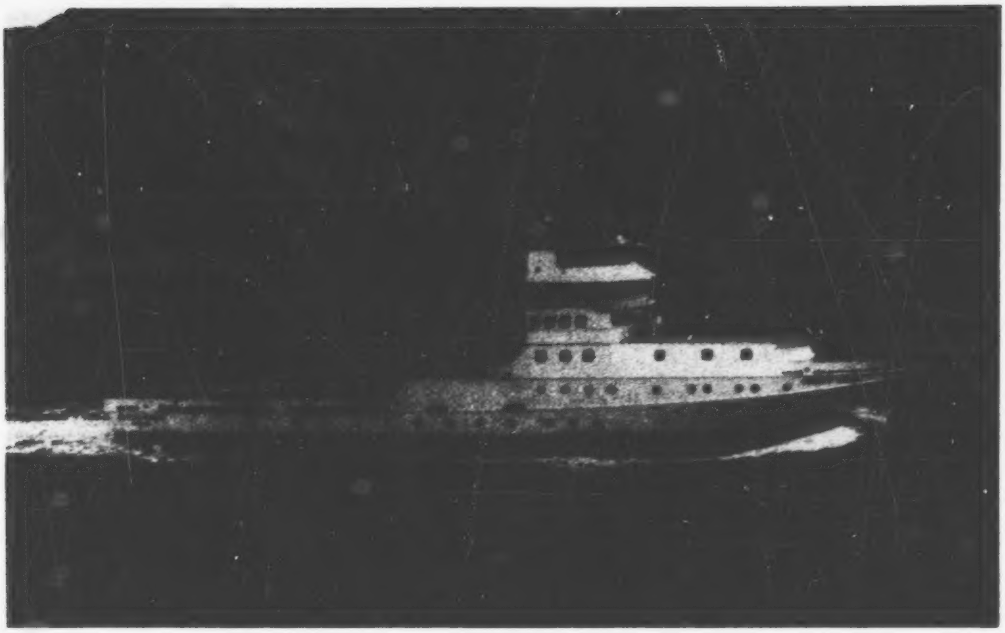
14.64 **DFO fleet size.** The approximate fleet size and replacement values are:

	No. of Vessels	Value (Millions)
Fisheries Management	103	$ 235
Fisheries Research	19	95
Hydrography/Oceanography	120	345
Total	242	$ 675

(Note - several hundred smaller vessels, generally under 6 metres in length, are not included in these statistics.)

14.65 **Audit scope.** We examined the activities carried out by DFO in acquiring major vessels. These included planning for the orderly replacement of vessels as they reach the end of their economically useful life. We also examined the project management procedures to ensure they complied with Treasury Board project management procedures and with normal commercial practice.

14.66 **Needs definition.** Vessel acquisition plans for all four DFO activities are contained in a two-part, multi-year Vessel Acquisition Strategy Plan (VASP). The plan establishes the need for vessels in terms of ship-day requirements. The latest plan (VASP III) was developed in 1981 and covers the six-year planning period from 1982 to 1988. One part, VASP A, which details replacements and mid-life refits of existing vessels, was approved by Treasury Board in May 1982 as an overall plan. Each replacement or major refit project would require individual project approval. The second part, VASP B, covering additions to the fleet, has not been approved by Treasury Board.



The John P. Tully *hydrographic survey vessel acquired by the Department of Fisheries and Oceans (see paragraph 14.72).*

14.67 A key feature of the original VASP was the planned allocation of funds by year with a provision that, once approved, an individual project cash-flow forecast could be adjusted to suit the realities of an actual multi-year building schedule. This feature is required to recognize the practicalities of the ship-building industry where delays in equipment delivery can affect the final delivery of a vessel with an accompanying delay in progress payments. The provision was rescinded in July 1985.

14.68 **Conclusions.** The justification of ship-day requirements is inadequate in some program areas. Patrol vessels are justified on the basis of an operational analysis study that has not been validated against actual operational experience. Ocean Sciences and Surveys (OSS) did not make an overall assessment of ship-day requirements flowing from program priorities within the OSS mandate in preparing VASP III. Instead, justification was provided for individual additional vessels. For the Atlantic Region, for example, justification for a new multi-disciplinary vessel was predicated on the increase in the number of scientists at the Bedford Institute of Oceanography. In the Pacific Region, OSS did not provide full justification for vessel needs in support of VASP III.

14.69 The Department recognizes these problems and has advised us that in preparation for the forthcoming acquisition plan (VASP IV), it is effecting improvements required in program planning and justification for levels of service at sea.

14.70 The Department of Fisheries and Oceans should use annual ship-day requirements based on levels of service derived from specific program policy and priority statements to justify plans for vessel acquisitions.

14.71 **Options analysis.** In developing the VASP, the Department had analysed various alternatives, such as helicopter patrols, prior to deciding on ship construction to meet their needs. This approach is sound.

14.72 **Acquisition process.** We reviewed the acquisition of the two most recent major vessel construction projects, the hydrographic survey vessel, *John P. Tully*, and the patrol ship, *Leonard J. Cowley*.

14.73 The process being followed by the Department in acquiring replacement vessels is in accordance with procedures established by Treasury Board for managing capital projects. Our findings indicate that the processes of statement of requirement, design, specification development and contracting are comprehensive and sound.

Free Publications

Background

14.74 Information, as defined in the Estimates, cost the federal government in excess of $350 million in 1984-85, a significant portion of which was spent on publishing. Government departments publish information for the public in general and for certain groups in particular, either because they are required by legislation to do so or because they believe it to be needed.

14.75 Government publications such as books, periodicals, booklets and looseleaf materials are either priced or free. Free publications are those publications that are made available to the public without charge. These free publications and the administrative policies and procedures that govern them were the subject of this audit.

14.76 Free publications are produced, distributed and made accessible under the authority of Treasury Board and departmental administrative policies. The government's administrative policy and procedures on publishing for both free and priced publications are set out in the Treasury Board's Administrative Policy Manual and have been in place since 1977.

14.77 Treasury Board is responsible for interpreting the publishing policy, monitoring its implementation, evaluating its effectiveness and maintaining its relevance.

14.78 The Publishing Centre of the Department of Supply and Services (DSS) is responsible for supervising and co-ordinating government publishing activities. This includes the responsibility for determining in consultation with departments the category – free or priced – of all publications planned.

14.79 Departments are expected to implement all aspects of the administrative policy on publishing through a Departmental Publications Officer.

14.80 "Publishing" should not be confused with "printing." Printing is one stage of publishing, a complex process that ends up with a finished product. It comprises four basic stages – identifying the need for a publication and estimating costs; planning for production and preparing a manuscript; printing; and distribution.

14.81 The first stage, identifying a target audience's need for published information, is critical. Here, a department decides that, to further a program, there is a need to provide a target audience with information in printed form, relative to other communication methods. The decision to publish commits the department to all the costs arising from the subsequent stages of the process.

14.82 Second-stage costs include the time of personnel involved in designing, writing, translating, editing, and preparing the publication for print. In the third stage, there are printing and binding costs. Finally, there are all the costs associated with distribution (shipping, mailing, storage, inventory maintenance), including the disposal of unused or out-of-date copies.

Audit Scope

14.83 We identified the 10 departments that in 1984-85 spent most on "Information" as defined in the Estimates and chose 4 for examination – Energy, Mines and Resources, Fisheries and Oceans, Regional Industrial Expansion, and National Health and Welfare. We looked at how Treasury Board, DSS and departmental administrative publishing policies and procedures were being applied in respect of free publications and the extent to which expenditures were being made with due regard for efficiency and economy.

14.84 Our examination covered all the stages of publishing and the financial systems in place that might be expected to report the costs of a decision to publish.

Treasury Board and DSS: Policies and Procedures

14.85 We found that the Publishing policy devotes little attention to free publications although they appear to be heavily favoured by departments as a communications method. In volume and costs, these publications are at least as significant as priced publications. As well, the administrative policy lacks criteria for deciding whether a publication should be free.

14.86 The consultative procedure, established between the Publishing Centre and departments to advise on whether publications should be free or priced, is not working.

14.87 With the exception of printing costs, the policy is silent on whether the other costs associated with a publication – manuscript preparation, artwork, graphics, translation, distribution and shipping, etc. – are to be estimated, tracked and reported.

14.88 A 1984 Treasury Board circular called for a yearly departmental publishing plan that would include data on the total cost and number of publications proposed and, for each title, the total and unit cost. The components of the total cost were not defined. Where costs are identified by departments, we found they often referred only to printing costs.

14.89 We found no evidence that the Treasury Board Secretariat is discharging its responsibility for monitoring the system of free publication production.

14.90 The publishing policy requires accurate records and a formal disposal method for surplus priced publications, but not for free ones.

Departmental Implementation of Policy

14.91 Generally, in the four departments examined, we found that the concept of the Departmental Publication Officer was not working effectively. We could not identify responsibility for overall publications management and the monitoring of free publications production, nor could we determine or find out from anyone the total number of free publications.

14.92 The significant costs of free publications in most cases were not routinely and systematically estimated prior to publishing, nor collected afterward for comparison. Generally, unless resources were to be contracted from the private sector, the principal cost component used for planning and budgeting purposes was the cost of printing (see Exhibit 14.4).

14.93 Further, we found that:

- The total cost of all free publications taken together could not readily be determined.
- The advantages and disadvantages of making a publication free were rarely considered formally.
- Departments did not adequately address how the need for a free publication was to be justified and, assuming publication, how costs were to be estimated.
- Insufficient attention was given in the management of publications to the rate at which inventory was moving, leading to surplus or obsolete stocks.
- Complete indexes or catalogues of all departmental free publications were either not readily available or did not exist.

Exhibit 14.4

MAJOR COST COMPONENTS OF A PUBLICATION

Stage 1 - Need justification and estimating

- Determine need
- General planning
- Cost estimating

Stage 2 - Manuscript preparation

- Designing and planning
- Writing
- Editing first language
- Translation; editing second language
- Word processing
- Author's alterations
- Graphics and photos
- Typesetting
- Artwork assembly

Stage 3 - Printing, etc.

- Printing and binding

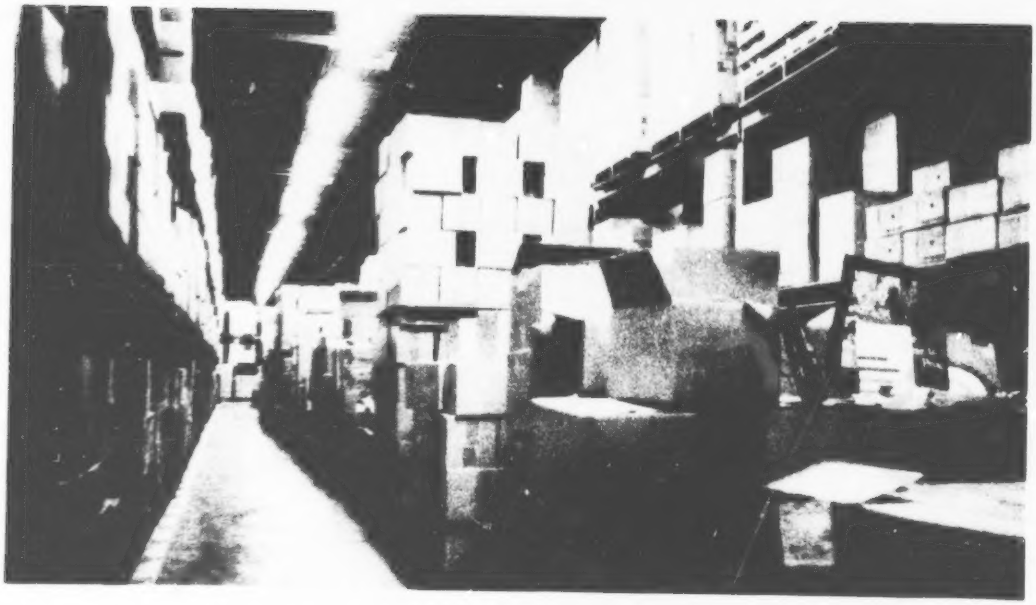
Stage 4 - Distribution and storage

- Promotion and marketing
- Preparing mailing lists
- Packaging
- Mailing / bulk shipping
- Storage
- Other handling

The shaded areas indicate cost components that we found were generally given insufficient attention by departments in estimating costs (see paragraph 14.92).

14.94 The effect of all this is to allow free publications in most cases to proceed without adequate consideration of the costs and benefits of doing so. This leads, in turn, to a lack of consideration being given in these cases to efficiency and economy in their production.

14.95 The departments we examined had some of the elements of adequate free publication management and had begun to address some of the identified weaknesses before the audit commenced.



The boxes in the aisle contain obsolete or surplus free publications to be disposed of following a management review. Weight: 37 tons (see paragraph 14.95).

Recommendations

14.96 To enhance accountability and ensure that expenditures on free publications are made with due regard for economy and efficiency, Treasury Board should undertake a review of its policy and procedures for free publications in concert with the Publishing Centre and with departments and:

- establish clear criteria for deciding whether a publication will be free or priced;
- establish the appropriate level of financial and physical controls required; and
- establish clear levels of reporting on free publications in Part III of the Estimates and in the Public Accounts.

14.97 The departments we examined should ensure that:

- decisions to publish free publications are made with due regard for economy and efficiency;
- where major expenditures may be incurred, the need for the free publication and its significant estimated costs are set out in a written analysis by the originator;

- **where major expenditures may be incurred, full responsibility for the publication, including the reasonable estimation of staff time as well as other significant actual costs, is assigned to the originator of the publication; and**

- **adequate inventory controls are in place along with a formal procedure for disposing of surplus or obsolete stocks.**

14.98 Given our overall finding of a lack of due regard for economy and efficiency for free publications in these four departments, other departments and agencies should review their free publications systems to ensure that procedures are being implemented to establish appropriate controls over their production, issuing and disposal.

Department of Energy, Mines and Resources
Management of the Public Communications Function

Introduction

14.99 In the Department of Energy, Mines and Resources (EMR), communicating with the public is important to achieving the objectives of the Energy and the Minerals and Earth Sciences programs. The Department produces a wide variety of material for scientific and general audiences. For example, small, specialized scientific audiences are regularly offered 'open files' and publications describing the results of research. General audiences can obtain both scientific and general material, ranging from free pamphlets about saving energy in the home or about interpreting maps, to priced publications about fossils or industrial energy technology, to sample rock kits, topographical maps and air photos.

Audit Scope

14.100 We examined the assignment of responsibility for managing and co-ordinating the communications functions. We also assessed whether the information products for the general public were being developed economically and whether the Department was measuring the effectiveness of these products. Our audit excluded communications between scientists and their peers in the research community, map production and distribution, and work related to the information needs of the ministerial offices, although this is a major responsibility of EMR's central Communications Branch.

How Communications are Organized in EMR

14.101 A communications function is common to almost all departments. But EMR's operates on a larger scale than most, with a central Communications Branch (96 person-years and $13 million budget for 1986-87) and many program area communications units throughout the Department.

14.102 In addition to providing direct support to the Ministers, the Communications Branch manages departmental advertising, exhibits and audio-visual services, as well as a portion of departmental publishing. The Branch produces about 140 new information products each year for the program areas. In the publishing field, Communications Branch has focused on "general" publications – material, whether scientific or not, that is aimed at broad segments or all of the Canadian public.

14.103 Any program in the Department can develop both free and priced publications on its own. We identified at least 16 program areas with publishing responsibilities. For example, the Geological Survey of Canada (GSC), which has been operating since 1842, published 190 scientific reports in 1985. The Canada Centre for Mineral and Energy Technology (CANMET) publishes about 450 technical research reports annually. All this program material has a strong scientific and technical orientation, but some of it could be of interest to segments of the general public.

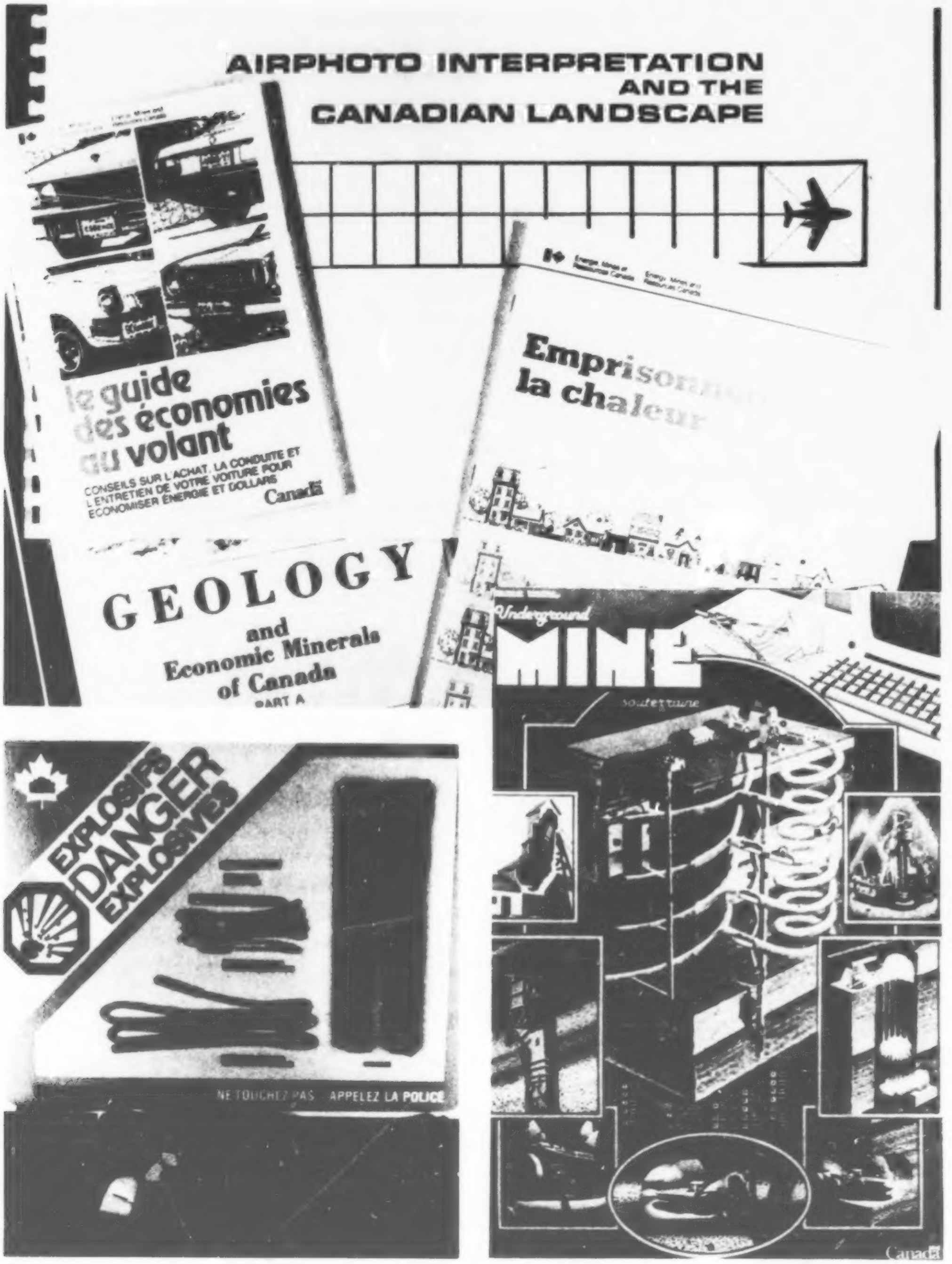
14.104 Other program areas also develop general-interest material independently or, as in the case of Home Energy Programs Division, in co-operation with the Communications Branch. For example, Home Energy distributes free of charge about 4 million pieces of material every year on conserving energy in the home.

Unclear Responsibility for Managing and Co-ordinating the Communications Function

14.105 Our 1982 Report noted a lack of clarity in the allocation of responsibilities for the communications function between the Communications Branch and EMR's Sectors. Subsequently, a memo from the Deputy Minister stated that the Communications Branch should manage the communications function throughout the Department. The Branch now manages the majority of advertising, exhibits and audio-visual work. However, it does not manage all the publications work.

14.106 A 1985 statement of mandate, approved by the Deputy Minister, requires that the Communications Branch monitor and evaluate all departmental information activities. But this responsibility is not carried out fully. For example, we identified products that had been released but not reviewed by the Branch for adherence to the Federal Identity program, Treasury Board sex stereotyping policies, and departmental standards for language quality. Although the Branch has a broad mandate, it lacks the means to carry out its assigned responsibilities.

14.107 Treasury Board publishing policy requires that the Department designate a "departmental publications officer" to review all proposals for new publications and to submit an annual plan to the Department of Supply and Services (DSS) describing all proposed departmental publications. The Director General of the Communications Branch, as the departmental publications officer, submitted a publishing plan for 1984-85, but it excluded some free publications and almost all priced publications - for example, the planned nine volumes on the geology of Canada by the Geological Survey of Canada, and a book from the Surveys and Mapping Branch entitled "Airphoto Interpretation and the Canadian Landscape."


AIRPHOTO INTERPRETATION AND THE CANADIAN LANDSCAPE
le guide des économies au volant
CONSEILS SUR L'ACHAT, LA CONDUITE ET L'ENTRETIEN DE VOTRE VOITURE POUR ÉCONOMISER ÉNERGIE ET DOLLARS
Canada
Emprisonnez la chaleur
GEOLOGY and Economic Minerals of Canada PART A
Underground MINE souterraine
EXPLOSIFS DANGER EXPLOSIVES
NE TOUCHEZ PAS APPELEZ LA POLICE
Canada

A sample of the information material the Department produces, both to stimulate general public awareness of its activities and to inform specific audiences. The Explosive Safety kit teaches school children the dangers of explosives; other publications range from general interest to highly technical (see paragraph 14.109).

14.108 Some program areas have formal means to co-ordinate their own communications efforts; others do not. The Communications Branch has its own planning process for the many general-interest products it is developing for programs, that provides consultation, advice and assistance. This represents considerable improvement since 1983 when the Department's Internal Audit Group reported the lack of a viable Branch operational planning process. However, unless requested to do so, the Branch is usually not involved with the technical publications intended for the scientific community. Thus it cannot readily identify all the independent publishers in the Department or produce a complete publications plan.

14.109 The Communications Branch has begun to clarify its mandate by developing a departmental style guide and four draft policies covering advertising, audio-visual material, exhibits and publications. However, the proposed publications policy does not clearly define the term 'general publishing', which would identify the publications for which the Branch would assume responsibility. For example, the policy does not make it clear whether publications such as a GSC series of books on rocks and minerals for collectors would be viewed by the Branch as of interest to the general public, leaving it unclear whether responsibility rests with GSC or the Branch. In addition, this policy does not identify who is responsible for ensuring that there is a need for the publication, that alternative methods of communication are considered, and that objectives, target audience and cost estimates are defined in detailed product plans.

14.110 In examining the assignment of responsibility for providing information to the general public, we observed that EMR has more than 40 information outlets, reporting to 9 different organizational units, each with its own cross-section of departmental information.

14.111 The lack of clarity in the mandate for managing the communications function hampers the Department's ability to provide a broad-based and co-ordinated information service. For example, EMR lacks a master catalogue of all of the Department's general-interest publications showing where they can be obtained. Nor does it have an up-to-date list of expert contacts within the Department that could help information office staff respond to public enquiries. Because the current allocation of responsibilities does not include co-ordination of the information outlets, EMR is missing opportunities to maximize public awareness of its program objectives, and the public misses an opportunity for "one-stop shopping".

14.112 **The Department of Energy, Mines and Resources should clarify the responsibility and authority for managing the communications function and for co-ordinating communications with the general public.**

> *Department's response: Mandate issues as identified by the audit will be reviewed and clarified, with special reference to publications and public access.*

Assessment of Information Products

14.113 To assess whether EMR is being economical in producing material for the general public, we selected 25 products and followed them through their life cycle, from their initial planning, production, distribution and evaluation, through, for some products, to the decision to reprint or to destroy surplus material. We selected the 25 products from the Communications Branch and from 13 different program delivery areas. The products represented different types of communications activities directed to the general public or a segment of the general public, and included both old and new products. Most were discretionary products, directly related to program delivery. The publications selected were both priced and free, and included posters, pamphlets, booklets and bound volumes. The photograph illustrates some of the products selected.

Weaknesses in Product Planning

14.114 After the initial planning stage where a product is approved in principle, we would expect the originator to consider and document more detailed planning information before starting to develop the product. For example, for each product we would expect that the originator would document the objectives, define the target audience, estimate costs and benefits, give reasons for selecting a particular communication alternative, and indicate the proposed method of distribution.

14.115 For all the products, we were able to obtain a general statement of the objectives and identification of the target audience that the Department wanted to address. Many of the products were aimed at a specific segment of the general public such as school children, homeowners or rock collectors.

14.116 **Knowledge of the target audience.** After generally identifying the objectives and the audience, we would expect the originator to define in more detail what results the Department would like to bring about by publishing a product. This would require a knowledge of the types of people the Department would like to reach, how best to reach them, and what the audience already knows or understands about EMR's policies and programs.

14.117 Many of the product files we examined lacked this kind of information about the target audience profile. For example, the files for a poster that depicts a typical underground mine did not contain objective information about the public's understanding of the mining industry. Mineral Policy Sector has requested such information to help in developing its series of mining posters but, for cost reasons, a study has not been carried out yet.

14.118 The Home Energy publications and various advertisements were supported with profile studies of the target audience. For lower-impact or lower-budget products than these, we recognize that formal analyses or studies to define the target audience may not be cost-beneficial. Yet, where formal studies were not carried out, the files did not adequately document the information that was known, or the assumptions being made about the target audience.

14.119 **Cost estimates.** Product plans usually contained estimates of contract costs. However, none of the product plans contained cost sheets that estimated other significant costs and a total planned cost for the product. Significant costs could include planning, writing, editing, creative design, translation, printing, production management, distribution, storage and evaluation.

14.120 **Comparison of costs and benefits.** We found little evidence that expected costs and benefits of communications products were compared before a decision was made to proceed with development. For example, the Surveys and Mapping Branch began work in 1974 on a textbook on the interpretation of aerial photographs. The book was intended for internal departmental use and for senior high school students, university students, the energy and resource development industries, and others who were just beginning to use air photos. The book, "Airphoto Interpretation and the Canadian Landscape", priced at $60, became available in May 1985.

14.121 From our review of the project files, we concluded that before proceeding with development of the book, the Department failed to estimate all significant costs associated with producing a publication of this nature. There is no evidence that the Department weighed estimated costs against the expected benefits, such as improved sales of departmental air photos. We were unable to determine the total costs for the 4,150 copies printed. However, "out-of-pocket" expenses were approximately $300,000 and several EMR staff spent months, and in some cases years, preparing the figures and plates, editing the material, and co-ordinating the development process. At the time of our audit, 62 per cent of the books were in inventory, 24 per cent had been sold and 14 per cent had been distributed free of charge.

14.122 **Alternatives.** We would have expected to see analyses of alternatives, such as whether a publication would be more cost-effective than an exhibit or advertising. However, the files generally lacked information on whether the Department had considered alternative methods of communicating the desired message. For free publications, the individual product files lacked evidence of formal consideration of whether to charge or not. Most Communications Branch publications and all Home Energy publications are issued free of charge.

14.123 **Distribution plans.** In several cases we could not find plans prepared before development for ensuring that the products reached their target audience. For example, the file for the Explosives Safety Kit did not have a distribution plan to address the question of how the kit would reach its intended audience of school children and police forces. The kit took five years to develop; one year after completion, 55 per cent of the 2,070 kits produced had been distributed to schools in two provinces. Five per cent of them had been distributed to police forces and others; 40 per cent remained in inventory. The kit is distributed free of charge; total costs are unknown.

14.124 **Communications Branch review.** The Communications Branch has a committee that reviews proposals from the Sectors for products that will require assistance from the Branch. We were informed that through this review process, the Branch's directors and program officers who are on the committee scrutinize the proposals regarding their benefits compared to their costs, format and alternative delivery mechanisms. However, we found little documented evidence of either a formal scrutiny of the proposals or the rationale for the decisions made. We also could not find information in the product files that would adequately assist such a committee to make its decisions with due regard for economy. Nor was the standard form for submitting product proposals adequate for the committee to address such matters as product need, objectives, target audience and alternatives in a consistent and thorough manner.

14.125 To summarize, many of the product files we reviewed lacked much of the information described above. Better planning data would help the Department to determine initially whether the project expenditure would be worthwhile, and later to determine if it was cost-effective.

14.126 The Department of Energy, Mines and Resources should ensure that plans and files for information products contain adequate information on objectives, costs and benefits, target audience characteristics, alternatives, timeliness and proposed distribution methods.

> *Department's response: Documentation associated with the communications planning process will be improved to include specific reference to the factors identified in the audit.*

Lack of Product Cost Information

14.127 Once a product has been approved and is under development, we would expect the Department to record all the significant costs incurred, including actual or estimated staff costs where applicable. The level of effort devoted to collecting and recording costs must be weighed against the benefits of controlling the costs of product development, making an assessment of a product's effectiveness compared to its cost, and improving the estimates for future products.

14.128 EMR does not record staff costs for individual products. In some cases, for example the book on airphoto interpretation, we believe that significant staff costs were incurred. For most products the originators acknowledged that specific staff resources had been required to write, edit, design, translate and to manage product development.

14.129 The Department does record actual costs for services contracted from DSS or from outside suppliers for creative design, printing and distribution. However, these costs are not always attributed to particular products. The Communications Branch's project reporting system does not report actual expenses incurred for each product. Also, for several program area products, the originators identified contracts, but could not supply records of actual expenditures for them. We found little evidence that significant actual costs were analysed and compared to estimates.

14.130 The Department of Energy, Mines and Resources should investigate the feasibility of recording estimated or actual staff costs for individual products or groups of related products.

14.131 Where practical, and where justified by the cost and market impact of an information product, the Department of Energy, Mines and Resources should identify and record the actual costs of individual products for planning and control purposes.

> *Department's response: Selective recording of actual costs has begun and will be extended.*

Inventory Management

14.132 Priced departmental publications for the general public are stored mostly by DSS. Free EMR publications for the general public are usually stored in a private sector warehouse under a $200,000 standing offer agreement managed by the Communications Branch.

14.133 The Branch does not have an adequate inventory control system including, for example, a current list of all publications, the quantities on hand, and the rate at which they are being distributed.

14.134 The Branch has recognized the need to improve its inventory system in order to minimize out-of-stock situations, provide appropriate re-order levels and minimize storage costs. It is taking steps to correct the problems.

Lack of Evaluations of the Communications Function and Communications Products

14.135 The Office of the Comptroller General requires that the effectiveness of all programs, including communications activities, be evaluated periodically. Treasury Board also requires pre-testing of all advertisements and post-evaluations of those that cost over $300,000.

14.136 To assess whether communications activities support the achievement of EMR's program objectives, we would expect evaluation studies to be carried out at several levels, including:

- evaluations in program areas to determine whether significant individual products contribute to program objectives;
- evaluations of significant individual products or series of products to determine whether they meet the objectives for the products, such as whether they reach a certain percentage of their target audience and whether they bring about the desired change in that target audience; and
- evaluations of the departmental communications function, including the Communications Branch and the program communications units, to determine, for example, whether EMR meets the demands of the general public for information in such a way that people do not have difficulty locating the information they want.

14.137 Although some work has been done at each level, we believe more is needed. The departmental Program Evaluation Group has examined some products and related communications activities as part of its evaluations of major program areas. However, the results are seldom current enough to influence decisions about the future of particular products.

14.138 To date, the Communications Branch has relied on informal feedback as its primary source of evaluation information, choosing to focus its limited evaluation resources on the high-impact products. A permanent evaluation position was recently established to provide for an expanded and more systematic program of evaluation.

14.139 With the exception of the Home Energy Program, the program areas have generally relied heavily on informal, subjective feedback.

14.140 We recognize that formal evaluations of some products may not be cost-effective. However, without more effort in this area, the Department could be missing significant opportunities to promote public awareness of EMR's programs.

14.141 **Where it is cost-effective to do so, the Department of Energy, Mines and Resources should evaluate the effectiveness of its products so that the results can be considered in decisions to reprint existing publications or to produce new products to support program delivery.**

> *Department's response: See paragraph 14.143.*

14.142 Evaluations to date have not addressed the overall departmental communications functions, including such matters as how the general public finds out what information is available and where to get it, and how successful the general public is in locating, obtaining and using EMR information.

14.143 **The Department of Energy, Mines and Resources should evaluate how effectively it communicates information to the general public.**

> *Department's response: Work has already begun, as noted in the audit. It is not possible to allocate further resources to evaluation, but within existing resources, specific product evaluations of communications directed to the general public will be initiated.*

14.144 **Successful implementation of audit recommendations.** Three years ago, an internal audit report assessed the Communications Branch and reported serious weaknesses in its management. Internal audit has since noted that all its audit recommendations have now been addressed by the Branch, and corrective action has been taken.

14.145 **Conclusion.** Our audit identified the need to clarify the responsibility and authority for managing EMR communications with the general public, and the need for the Department to examine the effectiveness of its communications function in fulfilling program objectives, including contact with the general public. Throughout the department, omissions were noted in the cost information and other planning data available for the products that we examined. This points to opportunities to improve management practices and controls within the communications function.

14.146 We recognize the difficulty of introducing new processes and new activities, such as product evaluations, at a time when the Department is required to cut back person-years. It may be that our recommendations could be applied, at the outset, only to those products that consume the greatest number of dollars or have wide public impact. However, we believe that implementing these recommendations would provide better information for decision makers and assist them in providing a more cost-effective use of communication resources.

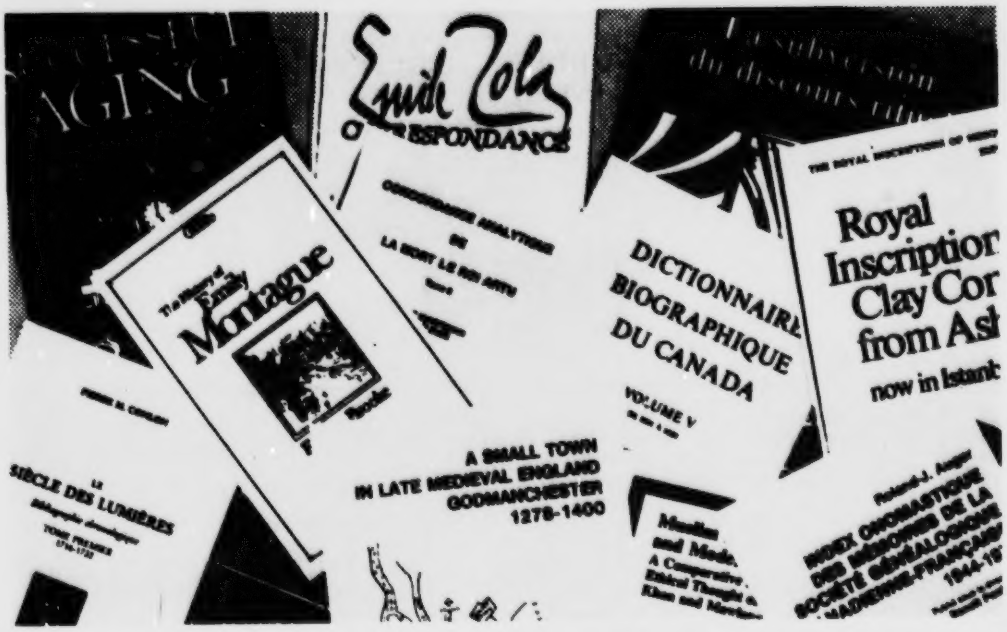
Social Sciences and Humanities Research Council

Overview

14.147 The Social Sciences and Humanities Research Council (SSHRC) was established on 29 June 1977 under Part 1 of the Government Organization (Scientific Activities) Act, 1976. It is a departmental corporation under Schedule B of the Financial Administration Act, reporting to Parliament through the Secretary of State. As a separate employer, the Council has the powers conferred to Treasury Board under article 7 of the Financial Administration Act. SSHRC is governed by the terms of the Public Service Staff Relations Act and is not subject to the Public Service Employment Act.

14.148 SSHRC's mandate is to promote and assist research and scholarship in the social sciences and humanities and advise the Minister in respect of such matters relating to such research as the Minister may refer to the Council for its consideration. The program objective is to promote and assist research and scholarship in the social sciences and humanities and to encourage excellence therein. This objective has been divided in four sub-objectives:

- to enhance the advancement of knowledge by assisting disciplinary-based research;
- to assist in and advise on maintaining and developing the national capacity for human resources development and the training of researchers;
- to promote targeted research in areas and themes of particular relevance and importance that would contribute to the fulfilment of national objectives; and
- to facilitate the dissemination of research results and increase Canada's international presence and recognition in the social sciences and humanities.


AGING
Emile Zola
CORRESPONDANCE
The History of Emily Montague
LA MORT LE ROI ARTU
DICTIONNAIRE BIOGRAPHIQUE DU CANADA
VOLUME V
Royal Inscriptions on Clay Cones from Ashur now in Istanbul
SIÈCLE DES LUMIÈRES
A SMALL TOWN IN LATE MEDIEVAL ENGLAND GODMANCHESTER 1278-1400
INDEX ONOMASTIQUE DES MÉMOIRES DE LA SOCIÉTÉ GÉNÉALOGIQUE CANADIENNE-FRANÇAISE

A sample of works subsidized by the Social Sciences and Humanities Research Council (see paragraph 14.149).

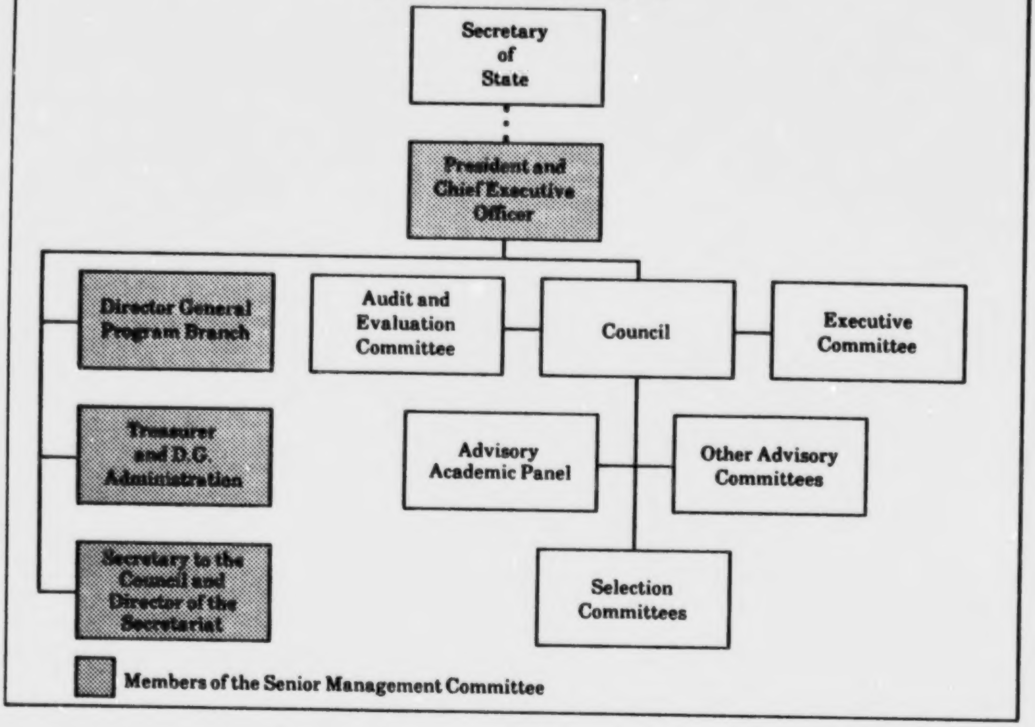
14.149 Social sciences and humanities cover a broad range of activities from the study of literature or ancient civilizations to research on pressing social and economic issues. Grants and scholarships can be awarded to any Canadian or permanent resident that meets the standards set by SSHRC. Recipients of SSHRC grants and scholarships are generally university students (at the master's and doctoral level), university professors, private scholars, learned societies and federations, and other organizations working in the field of social sciences and the humanities.

14.150 SSHRC is headed by a Council of not more than 22 members including the President and the Vice-President. These members, who come mainly from the academic community, are appointed by the Governor in Council. There is also an Executive Committee of the Council, consisting of the President, the Vice-President and at least six other members selected by the Council. This Committee carries out Council's functions between meetings. Council is also assisted by 61 grants and fellowships selection committees whose members are chosen by the Director General of the program branch and come from outside SSHRC, mostly from universities. (See Exhibit 14.5)

14.151 SSHRC's program comprises two activities: Grants and Scholarships, which accounts for 90 per cent of total expenditures; and Administration. SSHRC's expenditures for 1985-86 amounted to $57.2 million for grants and scholarships and $6.4 million for administration, program delivery and support. There were 107 authorized person-years. The administration of SSHRC is centralized in Ottawa.

Exhibit 14.5

SOCIAL SCIENCES AND HUMANITIES RESEARCH COUNCIL ORGANIZATION CHART


Secretary of State
President and Chief Executive Officer
Director General Program Branch
Treasurer and D.G. Administration
Secretary to the Council and Director of the Secretariat
Audit and Evaluation Committee
Council
Executive Committee
Advisory Academic Panel
Other Advisory Committees
Selection Committees
Members of the Senior Management Committee

Audit Scope

14.152 We examined the following aspects of SSHRC: the management process including management roles and responsibilities; general planning and human resource management; operational control; research communication; and program evaluation. Our findings are grouped under two headings: managerial problem-solving process, and operational management. Our annual financial audit showed that financial controls were satisfactory.

Observations and Recommendations

Managerial Problem-solving Process

14.153 In addition to Council and the Executive Committee, there is a Senior Management Committee consisting of the President who, as SSHRC's chief executive officer, acts as chairman, and the three senior officers of the organization.

14.154 The authority of the Council, the Executive Committee and the Senior Management Committee has been established. However, matters dealing with day-to-day operations, such as assignment of employees, co-ordination of adjudication schedules, cash management procedures, etc., are frequently dealt with at all levels. This situation leads to overlapping, delays in action and inefficient operations.

14.155 We noted delays in reaching solutions to some problems referred to Council. These problems are illustrated by the following examples:

- In June 1982, Council approved development of a system to monitor the results of the research it supports and asked several committees to advise Council about it. The system was to eventually permit a complete evaluation of the Research Grant Program, which awards about $17 million in grants annually. Almost four years later, the system was still not in place.
- In May 1984, Council approved the organization of a task force to study the operational objectives of the Strategic Grants Division. This decision followed a request of SSHRC's Program Branch and an internal audit report stating that the operational objectives lacked precision and that unless they were clarified it would be impossible to set up program structures to support achievement of those objectives. More than two years after the problem had been identified, the task force has not been set up.

14.156 In our opinion, delays in reaching solutions to identified problems jeopardize the best use of resources.

14.157 **Council should:**

- **clarify the role of the different management levels; and**
- **ensure that problems brought to its attention receive appropriate consideration proportionate to their importance.**

Council's response: The Council agrees with the recommendations and will address the issues noted in the recommendations and in the paragraphs preceding the recommendations at its next regular meeting.

Operational Management

14.158 In the operations area, the grant and scholarship payments that we audited had been processed in accordance with the peer evaluation process that SSHRC has in place, and had been approved by the President and/or Council.

14.159 **General planning and human resource management.** At the time of our audit, SSHRC's senior management had not established an overall operational plan covering its priorities, target dates and the co-ordination of its activities. Thus, SSHRC could not adequately plan its human resource needs, define its management information needs, and give managers adequate direction so that they could integrate their activities with those of the whole organization.

14.160 Moreover, SSHRC's senior management had not established workload indicators. As a result, it could not forecast its current or its future human resource needs. Management had not defined the tasks to be performed or the number and category of employees needed to operate its programs economically, efficiently and effectively.

14.161 For example, since 1979, the responsibilities of program officers in the Research Grants Directorate have been reduced significantly. There was no complete, formal review of employee job descriptions, categories and levels. The same selection criteria continued to be used in staffing, so that SSHRC was hiring people whose qualifications did not correspond to those required to do the work – hence there was a risk of paying salaries that were higher than warranted by the work involved or of employee's skills not being fully utilized.

14.162 We also observed that senior management had not prepared an action plan for balancing future personnel needs with resources in place. Neither staffing plans nor plans for filling key jobs had been prepared.

14.163 In 1985-86, there was a change of personnel in more than half the jobs at SSHRC. These were staffed either on an interim basis or by term or seasonal employees. We acknowledge that many of these changes resulted from an effort by senior management to allow employees to diversify their experience. However, the lack of a planned approach to staffing gave rise to serious chain-reaction problems because the departure of one employee generated the move of three to five other employees from one job to another within the organization. This situation had an effect on the efficiency of operations and generated additional staffing costs.

14.164 Moreover, no adequate plans were prepared to minimize the impact on employees following lay-offs and necessary person-years reduction. This lack of planning, combined with the uncertainty created by the possibility of further lay-offs in the public service, had a negative effect on the work climate and on labour relations. Therefore, SSHRC, having to deal with labour relation problems, incurred additional administration costs.

14.165 **SSHRC's senior management should:**

develop an overall annual plan defining its operational objectives and priorities, as well as the nature and timing of the various divisions' contributions to achieving that plan;

- **adopt a planned approach to the management of human resources based on the overall operational plan that includes an assessment of the future need for and availability of human resources, strategies for dealing with staffing and the departure of employees, and training and professional development.**

SSHRC's senior management response: Management will develop a global operational plan, integrating existing separate plans. It should be effective by the end of 1986.

A human resources plan will be established and linked with the global operational plan. It will consider the elements enumerated in this recommendation and should be effective by April 1, 1987.

14.166 **Project follow-up.** Before sending grant payments to beneficiaries, SSHRC requires that recipients agree to submit a financial report and a project report at the end of their research project.

14.167 In 34 of the 73 cases we reviewed (46 per cent), we found that a complete follow-up had not been made to ensure that the necessary reports had been submitted and that they were satisfactory. As well, the automated bring-forward system that was to have been introduced over a year ago was still not in place. In cases where there are unused funds or inadmissible expenditures, there is a risk that overpayments are not being recovered from recipients.

14.168 We noted that seventy-five per cent of the value of grants applicable to research projects representing expenditures of more than $19 million in 1985-86, were not subject to examination when the projects were completed. Consequently, there was insufficient work done to ensure that completed projects were carried out properly.

14.169 **SSHRC's senior management should:**

- **establish a follow-up system to ensure that projects have been completed and that any unused moneys or inadmissible expenses are being collected; and**
- **perform a detailed review of completed projects selected at random, (with site visits if necessary) to ensure that the project has been carried out in compliance with the grant agreement.**

SSHRC's senior management response: The integrated system in place for the management of grants and fellowships is being enhanced and now provides for automatic monitoring of the follow-up procedures.

> *By 1987-88, the follow-up procedures on subsidized research projects will include a detailed review of a small number of completed projects selected at random.*

14.170 **Results of research.** Since its establishment in 1977, SSHRC has distributed over $150 million in grants for research projects. However, SSHRC does not record systematically, in a readily accessible format, the results of the research it subsidizes. Consequently, it is not in a position to know what has been produced for the amounts invested in research, nor to make available the results obtained from these grants to the research community and the public at large. This can prevent potential users from being informed of works they could benefit from.

14.171 **SSHRC's senior management should provide to Council, at regular intervals, the titles and subject matter of the results of research. This information should also be made available to the research community and to other interested parties.**

> SSHRC's senior management response: *Management will make a concerted effort to establish a procedure for the systematic reporting by award holders and gathering by staff, of the information required to provide feedback to Council on the results of research it funds through its various research grants programs. This information will also be made available to other interested parties. Such a system should be in place by the end of 1987-88.*

14.172 **Program evaluation.** We found that SSHRC's objectives and sub-objectives had been defined clearly, which should permit a clear definition of operational objectives.

14.173 Program evaluation aims at periodically producing credible, timely, useful and objective findings on programs appropriate for use in resource allocation, program improvement and ensuring accountability.

14.174 At the end of 1983-84, the SSHRC approach to program evaluation was satisfactory but, since then, the financial resources of this function have been reduced. Present activities in the area of program evaluation are the result of initiatives undertaken before October 1984. Since then, no new program evaluation study proposals have been developed, and the position of Co-ordinator of Evaluation has remained unfilled. Consequently, SSHRC has not complied with government policy nor with its internal policy on program evaluation.

14.175 SSHRC has told us that the co-ordinator position is to be filled in mid-June 1986. Although the situation appears to be in the process of being corrected, there is still a gap of at least 19 months during which new initiatives in program evaluation have not been taken. This has resulted in reduction of information for making program decisions.

Council's General Comment

Council and its management agree with several of the recommendations of the Comprehensive Audit Report and management accepts this new challenge in line with the government's wish for thriftier operations. SSHRC is particularly pleased to note again the Auditor General's expressed satisfaction with Council's financial controls. It is equally reassuring to see that the Report mentions SSHRC's consistent care in applying its peer review process in operating its grants and scholarships programs.

Canada Oil and Gas Lands Administration

Background

14.176 The Canada Oil and Gas Lands Administration (COGLA) was established in 1981. According to Part III of the Estimates its mandate is to ensure the vigorous and responsible development of oil and gas on lands under federal jurisdiction that are not within a province. These lands include about 10.4 million square kilometres located in the north and the offshore (see Exhibit 14.6).

14.177 Responsibility for COGLA is shared equally between the Minister of Energy, Mines and Resources and the Minister of Indian Affairs and Northern Development. This relationship, brought about by a Memorandum of Understanding between the two Ministers, provides COGLA with an unusual organizational status. It is not a program or a branch within a particular department, nor does it have the independence of a Crown corporation. It is a single body representing the interests of two Ministers through the administration of the Canada Oil and Gas Act and the Oil and Gas Production and Conservation Act.

14.178 With about 200 people and annual operating expenditures of approximately $12 million, COGLA endeavours to fulfil its mandate by managing the rights associated with oil and gas interests and by regulating and monitoring the operational, occupational and environmental safety aspects of oil and gas activities.

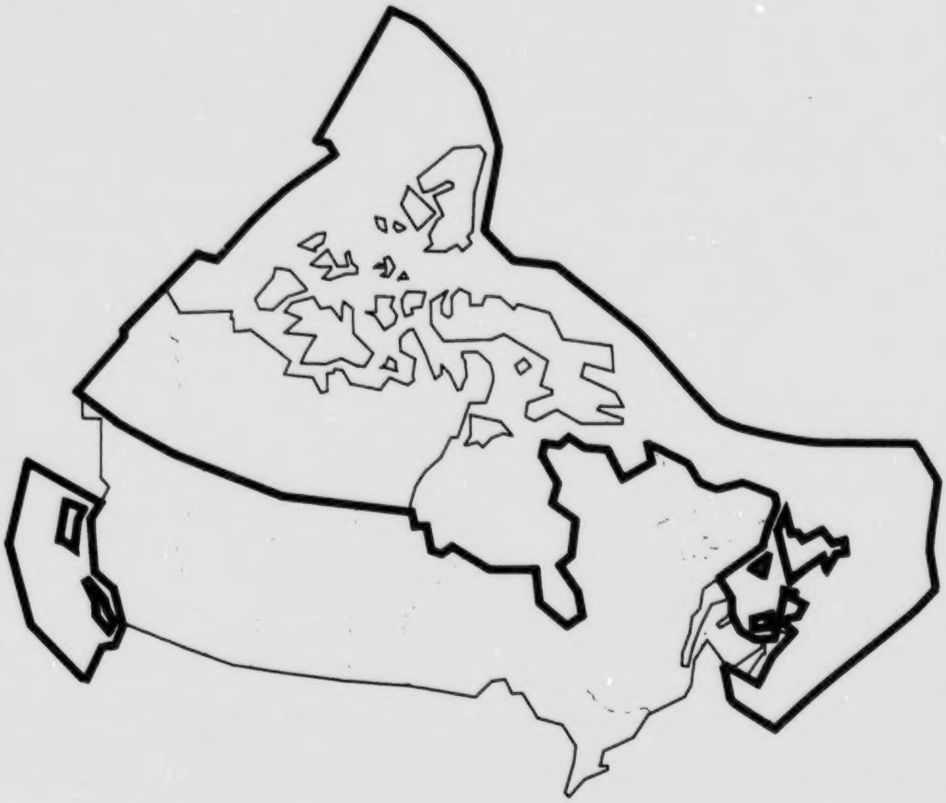
14.179 Additional functions performed by COGLA include administering the Environmental Studies Revolving Fund and the funds provided to the Province of Nova Scotia under the Canada-Nova Scotia Oil and Gas Agreement Act. In 1985-86, approximately $85 million was provided to Nova Scotia under this Act.

Audit Scope

14.180 Since 1982, we have audited various components of the Department of Energy, Mines and Resources Energy Program. This year's audit of the Canada Oil and Gas Lands Administration continues our focus on the Energy Program.

Exhibit 14.6

CANADA LANDS ADMINISTERED BY COGLA



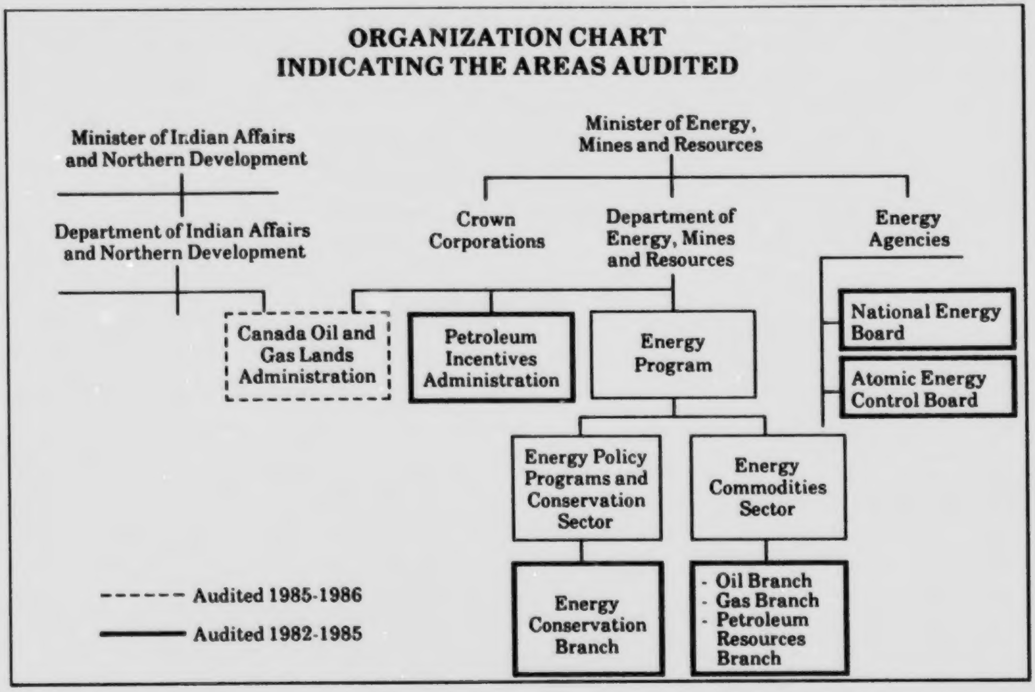
The bold outline shows the Canada Lands, administered by the Canada Oil and Gas Lands Administration.

14.181 Exhibit 14.7 shows how COGLA fits into the structure of the two departments and identifies the elements of the Energy Program covered by this and past audits.

14.182 The objective of our audit was to identify matters that, in our judgement, were of significance to Parliament, particularly with respect to due regard for economy and efficiency and the procedures to measure and report on effectiveness.

14.183 Our audit of COGLA was designed to be conducted in three distinct phases: an overview, a survey, and an examination.

Exhibit 14.7



ORGANIZATION CHART INDICATING THE AREAS AUDITED

Minister of Indian Affairs and Northern Development
Department of Indian Affairs and Northern Development
Minister of Energy, Mines and Resources
Crown Corporations
Department of Energy, Mines and Resources
Energy Agencies
Canada Oil and Gas Lands Administration
Petroleum Incentives Administration
Energy Program
National Energy Board
Atomic Energy Control Board
Energy Policy Programs and Conservation Sector
Energy Commodities Sector
Energy Conservation Branch
- Oil Branch
- Gas Branch
- Petroleum Resources Branch
------ Audited 1985-1986
—— Audited 1982-1985

14.184 The overview consisted primarily of background reading and analysis of legislation, annual reports and the like. The purpose of the overview was to gain an understanding of COGLA and the environment in which it operates.

14.185 The survey phase consisted of interviewing key COGLA personnel, identifying major operating procedures and activities, identifying major financial and management systems and practices, reviewing the results of other audits, inquiries and studies carried out on COGLA, and performing a detailed analysis of revenues and expenditures. The purpose of the survey phase was to gain additional understanding of COGLA and to identify potentially significant audit issues for further examination. The survey provided the following pertinent information.

14.186 An audit of COGLA, addressing issues of due regard for economy and efficiency, was performed by the internal audit group of the Department of Energy, Mines and Resources during 1983-84. COGLA is acting on the recommendations contained in the internal audit report.

14.187 COGLA's activities have also been studied by the Royal Commission on the Ocean Ranger Marine Disaster, whose reports were published in 1985-86. COGLA, in conjunction with other affected departments, is acting on the recommendations contained in these reports.

14.188 Provision of funds to the Province of Nova Scotia under the Canada-Nova Scotia Oil and Gas Agreement Act represents the largest category of expenditure included in COGLA's books of account. Of the approximately $85 million provided to the province, about $80 million represents transfers to the Canada-Nova Scotia Development Fund. Moneys transferred to the Development Fund are used by the province to fund projects approved by the federal Minister of Energy, Mines and Resources. The provincial Auditor General is responsible for certifying the accuracy of actual expenditures incurred and paid from the Fund. Ultimately, moneys transferred to the Canada-Nova Scotia Development Fund are repayable by the province.

14.189 At the conclusion of our survey, we determined that, with the exception of those items reported below, there are no other matters of significance and of a nature that should be reported to Parliament. In our opinion, it is unlikely that further audit work would identify additional matters of significance. Accordingly, we terminated our audit before the examination phase on the basis that additional work is not warranted at this time.

Rights Management Process

14.190 The rights to explore for and develop potential oil and gas resources are conveyed to explorers by way of exploration agreements negotiated by COGLA on behalf of the appropriate Minister. Regulations under the Canada Oil and Gas Act require the assessment of a transaction fee for each exploration agreement entered into or renegotiated.

14.191 Since the inception of COGLA, more than 170 exploration agreements have been negotiated or renegotiated. Transaction fees relating to these agreements exceed $1 million.

14.192 According to the annual reports filed by COGLA, most of the 170 exploration agreements were concluded in 1983 and prior years. However, final documents were not presented to the explorers for execution until 1985, and transaction fees were not assessed until 1986.

14.193 COGLA's systems and procedures did not ensure that transaction fees were calculated at the conclusion of the negotiation process. Nor did the management reporting system acknowledge the cumulative amount of unbilled fees resulting from agreements concluded but not entered into.

14.194 We believe that the delay in presenting final documents for execution, and COGLA's failure to promptly calculate and assess over $1 million in transaction fees, has reduced the likelihood of full collectibility.

14.195 **COGLA should assess transaction fees at the conclusion of each exploration agreement entered into or renegotiated and should modify its monthly**

management reporting system to include information on transaction fee assessments, collections and receivables.

> Departments' response: *An automated accounts receivable system is now in place to ensure that all collections and receivables are recorded against each pertinent exploration agreement. This system will produce monthly reports which will age these receivables and also project all potential revenue receivable on an annual basis. These amounts will be included in our monthly Management Report.*

Effectiveness Measurement

14.196 Since 1977, the government has required that departments and agencies conduct periodic program evaluation on a cyclical basis, and implement ongoing measurement procedures. In 1981 the government published detailed guidance on program evaluations.

14.197 We reviewed COGLA's ongoing effectiveness measurement activities to verify whether effectiveness indicators and measurement reports were being used for management control purposes. We found that the use and format of effectiveness indicators and measurement reports varied among managers within COGLA.

14.198 In 1984, the Program Evaluation Branches of the Department of Energy, Mines and Resources and the Department of Indian Affairs and Northern Development recommended a timetable for completing a program evaluation study of COGLA. That timetable included a program evaluation assessment during 1985-86 and an evaluation study during 1986-87. At the time of our audit, neither the assessment nor the study had been carried out.

14.199 In our opinion, a program evaluation study is particularly important at this time and should address, among other things, the following questions:

- Have the objectives of vigorous and responsible development been achieved?
- Have recent economic difficulties experienced by the petroleum industry affected COGLA's ability to achieve its mandate fully?
- Does COGLA's mandate result in gaps or overlaps in responsibility with other government departments, such as Transport, Environment, Fisheries and Oceans, and Indian Affairs and Northern Development?

14.200 **A program evaluation study of COGLA's program activities should be completed in accordance with a timetable agreed to by the Program Evaluation Branches of the Departments of Energy, Mines and Resources and Indian Affairs and Northern Development.**

Departments' response: A Program Evaluation is planned to be carried out in the near future. The Task Force on the Ocean Ranger Royal Commission recommendations has reported on ways and means of addressing possible overlaps and vacuums in the administration and regulation of frontier oil and gas activities.

FOLLOW-UP
OF
RECOMMENDATIONS IN PREVIOUS REPORTS

FOLLOW-UP OF RECOMMENDATIONS IN PREVIOUS REPORTS

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15

FOLLOW-UP OF RECOMMENDATIONS IN PREVIOUS REPORTS

Introduction

15.1 In Chapter 14 of our 1985 annual Report we included for the first time information on the status of action taken by departments and agencies in response to observations and recommendations of the Office and, where applicable, of the Public Accounts Committee. This initiative was well received.

Scope

15.2 This year we completed follow-up audits or reviews on important recommendations contained in eight chapters from the 1984 Report, additional follow-up on a 1983 chapter partially reported in last year's follow-up chapter, and follow-up of one chapter from our 1981 annual Report. In all cases, the scope of the audit was designed to permit us to arrive at an overall conclusion on the effectiveness of the actions taken in response to our recommendations.

Current Status

15.3 The status of actions taken in response to our recommendations varies considerably. In most instances, positive actions have been taken or are under way in response to the major recommendations; however, in a few instances little has been done.

Review of Cash Management - 1984, Chapter 4

15.4 Our 1984 Review of Cash Management focused on the management of the function, the cost of existing banking arrangements with financial institutions, and deposit and payment practices. We identified problems in all these areas. In our opinion, most of the problems and missed opportunities for savings identified in the chapter related directly to the lack of clarity of roles, responsibilities and relationships with respect to the cash management function. We made eight recommendations.

Scope of Follow-up

15.5 This year's follow-up consisted primarily of a series of interviews with officials from the Office of the Comptroller General, the Receiver General for Canada and the Department of Finance. We also reviewed material prepared since our 1984 Report such as Treasury Board directives, the new banking arrangements settlement, a report on the roles, responsibilities and relationships within the cash management framework, produced by an independent consultant, and the March 1986 progress report of the Office of the Comptroller General to the Public Accounts Committee. We did not perform a detailed audit of this information.

Developments to Date

15.6 In early 1985, the Public Accounts Committee held two hearings on cash management. The second hearing was held at the request of the Canadian Bankers' Association on the renegotiation of banking arrangements with the financial institutions. The Committee issued a report in May 1985 recommending that the Office of the Comptroller General be given the responsibility for all aspects of cash management. The Committee also expressed concern over the lack of progress in renegotiating banking arrangements and urged settlement by 30 August 1985. There were five recommendations in the Committee's report. The following are some of the actions taken by the government:

- In January 1985, the government approved a strategy for cash management. Approval in principle was also given to proceed with developing a number of specific initiatives such as strengthening current policies and practices for accounts receivable and scheduling payments to suppliers to meet due dates.
- In March 1985, a Senior Cash Management Review Committee was established to ensure good cash management co-ordination. The Committee is chaired by a senior official from the Office of the Comptroller General and includes representatives from the Department of Finance, the Department of Supply and Services, Treasury Board Secretariat and the Bank of Canada. Representatives from other departments participate as appropriate.
- In June 1985, the Deputy Minister of Finance provided the Public Accounts Committee with an update on the status of banking negotiations. He indicated that considerable progress had been made since the hearings, high priority had been placed on the banking arrangements, and the two parties were co-operating to ensure that a settlement was reached quickly.
- In July 1985, Treasury Board approved the establishment of a Cash Management Directorate in the Office of the Comptroller General. The directorate is now operating with a staff of 12.
- In January 1986, an independent consulting group completed a review of the roles, responsibilities and relationships for cash management in the Government of Canada. This review agreed with the assignment of responsibility for cash management to the Office of the Comptroller General and supported the establishment of a Senior Cash Management Review Committee.
- In March 1986, a progress report on cash management was prepared by the Office of the Comptroller General and submitted to the Public Accounts Committee, outlining the savings achieved through improved cash management practices and information on improvements in cash management policies and practices.
- In April 1986, a revised banking arrangements settlement between the government and the financial institutions went into effect.

15.7 Over the past two years, the Office of the Comptroller General has issued a number of directives on cash management. These include:

- a governmental strategy for cash management;
- policy and procedures for the collection of overdue accounts;
- debt write-off regulations;
- requirements regarding release of pay cheques;
- policy and procedures for the payment of suppliers' accounts;
- guidelines for monitoring and controlling obligations of Crown corporations to Canada;
- guidelines for strengthening current policies and practices for managing revenue and collecting debts owed to the government; and
- a drawdown policy for Crown corporation funding.

15.8 The Receiver General has also issued several directives and information bulletins. These are in respect of advance notice to the Receiver General of requisitions for large payments, electronic deposit of public money to the credit of the Receiver General for Canada, and the implementation of payment of suppliers' accounts policy - payment on due date.

Overall Conclusion

15.9 The government has now given cash management a high priority and has addressed all the recommendations we made in this area in 1984. Progress has been made in establishing good cash management practices. The full potential of savings from sound cash management practices will only be known once current and planned initiatives have been operational for a sufficient period of time to calculate savings reasonably.

15.10 One concern we have is that good cash management is still not always taken into account by many financial officers and program managers at the departmental level. The Office of the Comptroller General is aware of this and has informed us that it is developing training programs to aid in the implementation of good cash management practices. Initially, these training programs will be directed to financial officers and later to program managers.

Management of the Function

15.11 The Office of the Comptroller General has been assigned responsibility for cash management in areas in which Treasury Board has a mandate. The roles of other central agencies and departments have been clarified as a result of a study done by an independent consulting group and by consultation among the central agencies. The Senior Cash Management Review Committee, mentioned previously, has met on several occasions over the past year and a half. Therefore, there is now a leader in areas in which Treasury Board has a mandate for cash management and a means whereby central agencies and departments can get together and solve cash management problems. These changes, which meet our recommendations, were also fully supported by the independent consulting group's study.

Cost of Existing Banking Arrangements/Renegotiation of Banking Arrangements with Financial Institutions

15.12 The government and financial institutions have now completed negotiations for new banking arrangements. The new arrangements cover the period 1 April 1986 to 31 March 1989. The Office of the Comptroller General will be monitoring annually the cost-effectiveness of these new arrangements.

Billing, Collection, Deposit and Payment Practices

15.13 **Billing and collection.** The Office of the Comptroller General chose the area of accounts receivable for intensive cash management work in 1985-86. During the last two years, it issued two directives on the managing of accounts receivable dealing with the collection of overdue accounts and the strengthening of current policies and practices for managing revenue and collecting debts owed to the government. The Comptroller General's monitoring of this area indicates significantly improved collections of accounts receivable in 1985-86.

15.14 **Deposit.** A system for the electronic deposit of public money to the Receiver General account has been established and was scheduled for implementation in the summer of 1986. It applies to all departments, agencies and Crown corporations that operate within the Consolidated Revenue Fund, except for Revenue Canada and Canada Post Corporation where other arrangements have been made. It will replace the current Bank Settlement Voucher system.

15.15 Revenue Canada deposit facilities have been tendered to the financial institutions. The government's intention is to eliminate the use of Bank Settlement Vouchers for these deposits also.

15.16 **Payment.** The Office of the Comptroller General issued a directive in August 1985 requiring that payments to suppliers be made as close as possible to, but no later than, the due date. This policy was implemented in August 1985. The Office of the Comptroller General has informed us that its preliminary analysis indicates that savings are being realized and could be significant. The Office of the Comptroller General will continue to monitor the savings.

15.17 **Advance payments to Crown corporations.** In our 1984 Report, we noted that departments were remitting funds to Crown corporations and agencies before the money was actually required. The Office of the Comptroller General issued a directive in March 1986 outlining a policy that would closely tie advances to Crown corporations to their actual cash needs. This should result in interest savings to the government. The Office of the Comptroller General is monitoring adherence to this policy.

15.18 **Cash recoveries from Crown corporations.** A number of Crown corporations had accumulated large amounts of cash that were surplus to their requirements. During 1985-86, $364 million was recovered. A further $74 million is to be recovered in 1986-87. Based on the Office of the Comptroller General's calculations, annual interest savings of more than $30 million will be realized from the recovery of these amounts.

15.19 **Other savings and initiatives.** The Receiver General's Office has informed us that it has reduced the number of departmental bank accounts over the past year from 1,000 to 22, increasing the level of cash on deposit in interest bearing accounts by an estimated $20 million. A number of other cash management initiatives have occurred that could result in savings to the government. For example, the Department of Finance negotiated a reduced commitment fee on the unused portion of Canada's U.S. line of credit and reduced commissions paid to distributors of marketable bonds. The Office of the Comptroller General, as a pilot project, is testing the use of travellers' cheques in departments and agencies instead of travel advances for government travel. The government is also considering the use of credit cards for travel and payment of suppliers' accounts. In 1986 the Receiver General will be expanding, beyond the current pilot project, a voluntary program of direct deposit to their bank accounts of employees' pay, remuneration of judges, Members and staff of the House of Commons, and public service and military pensions.

Management of Travel - 1984, Chapter 7

15.20 In 1984, our tests of management practices and controls over travel in a number of departments indicated significant weaknesses in several areas. We commented on the need for certain improvements to the Travel Policy that we believed would lead to more efficient and economical travel management.

15.21 The Office of the Comptroller General and the Treasury Board Secretariat have not yet finalized changes to the Travel Policy and its provisions. These are intended to simplify pre-authorization procedures and to reduce administrative costs.

15.22 In the four departments selected for follow-up, our reviews of practices and procedures now in place for managing and controlling public service travel revealed no significant deficiencies in three of them. In the case of the Department of External Affairs, while there has been considerable progress in most areas, there remained weaknesses relating to the verification of Central Travel Service billings and a lack of follow-up on credits due from unused airline tickets.

15.23 On 30 April 1986 the Minister of Supply and Services announced that a private credit card organization had been selected to provide a corporate travel card system. As well, a commercial travel group was chosen to provide a reservation and ticket service for public servants travelling on government business. The travel card system and the new travel service are to be phased in over a period of from 18 to 24 months beginning in December 1986.

15.24 The new system and service are designed to:

- promote the use of credit cards by travellers, costing the government less than the former system;
- save money by replacing the present Central Travel Service Payment and Billing system, giving responsibility to departments and individual credit card holders to settle their accounts directly instead of through the former intermediary system; and
- improve accountability over the purchase of transportation tickets and financial administration of travel claims.

15.25 We will examine the implementation of the new Travel Policy and the operations of the new travel card and service systems when they have become fully operational.

Management of Job Classification - 1984, Chapter 8

Introduction

15.26 In 1984 the Office carried out a government-wide audit of the management of job classification in the federal public service. Job Classification refers to the processes used to determine the relative worth of jobs within the federal public service (actual rates of pay for most public service jobs are established through collective bargaining).

15.27 We observed that the job classification system was under considerable upward pressure and that countervailing forces, including management practices, were inadequate to offset these upward pressures. There was no clear accountability for the integrity of the job classification system or for making individual classification decisions, most of which were made under authority delegated to departments. A Treasury Board Secretariat audit of the quality of classification decisions, conducted in 1983, had revealed a serious rate of misclassification - one in every four public servants was misclassified – most of them over-classified – entailing a net annual payroll cost of $125 million in 1983.

15.28 Our audit report contained five recommendations aimed at achieving improvements in the following three areas:

- controls over quality and awareness of the cost implications of classification decisions;
- central agency monitoring and control of the job classification system; and
- accountability of Treasury Board Secretariat and departments for job classification.

Developments Since 1984

15.29 The Public Accounts Committee held two hearings in May 1985 on job classification. The Committee issued a report to the House with a recommendation that the Treasury Board Secretariat report back to the Committee in April 1986 on its progress in implementing corrective measures. This was done.

Scope of Follow-up

15.30 Our follow-up report is based on a review of the reports submitted to the Public Accounts Committee by Treasury Board Secretariat (TBS), an updated report, provided by TBS, of progress against each recommendation and a review of selected documents and discussions with TBS officials. Because several of the TBS initiatives have been undertaken since May 1985, and in some cases are not fully implemented, we have not conducted an on-site verification of the efficacy of the corrective measures.

Quality Controls/Awareness of Cost Implications

15.31 We recommended that TBS and departments ensure that classification decisions are subjected to rigorous and effective quality control measures before they are implemented. We also recommended that TBS and departments develop measures to ensure that consideration is given to the cost implications of organization changes and related classification decisions. These recommendations were intended to ensure that classification decisions are correct when they are made and that the cost implications of classification decisions, particularly upward reclassification, were known and accounted for. Corrective action would require, among other things, that TBS ensure that classification standards - the basis for accurate classification decisions - are current and that departments improve controls over making classification decisions to ensure their accuracy relative to the classification standards and the work being performed or to be performed in the positions being classified.

15.32 Treasury Board Secretariat reports that the following corrective measures have been implemented:

- A special task force has been established to review the 50 classification standards that have not undergone a significant review in the last 10 years. Six reviews have been completed - the remaining 44 standards will have been reviewed and updated by 1 April 1987. A five-year cyclical review of classification standards will begin in 1987-88. By 1988-89, all 69 classification standards will have been reviewed; none will be more than five years old.

- TBS is implementing a "key job system". This involves identifying actual positions in departments to be used as references in the classification of other positions in the same department. To date, some 24 positions in 9 major departments have been identified as key jobs in several major occupational groups. When fully implemented, the key job system will provide references for approximately 100,000 positions.

- In departments, classification decisions must now be made by a committee that includes at least two line managers knowledgeable in classification. Further, prior to reclassifying a position upward and promoting the incumbent, departments are required to ensure that the duties actually performed coincide with those set out in the job description. TBS reports that since August 1985, this review has resulted in departments rejecting 16.9 per cent of upward reclassification requests.

- The automatic funding of upward reclassifications has been eliminated. Managers are required to attest that the cost implications of a classification decision are known and that funds are available. TBS will be examining the capability of a new information system, implemented on 1 April 1986, to estimate the cost effects on payroll attributable to departmental classification activities.

Central Agency Monitoring and Control

15.33 Our recommendations in this area were that TBS have good information on the performance of the classification system on a service-wide basis as well as on a departmental basis; that this information be collected in a systematic and co-ordinated fashion so as to avoid duplication of effort; and that classification problems be corrected effectively and promptly, through the application of sanctions where necessary.

15.34 TBS reports that the following corrective actions have been taken:

- Departments are required to submit annual classification monitoring and audit plans for review by TBS.

- Departments are required to conduct biennial audits of the quality of their classification decisions using standardized TBS audit methodology and subject to TBS verification. Results are reported to TBS for compilation on a service-wide basis. The first audit was conducted in 1985-86 and indicated a current misclassification rate for the public service as a whole of 11.4 per cent. This audit examined the classification of 3,568 positions and is accurate within ± 2 per cent for the public service as a whole, 95 per cent of the time. The statistical methodology used was similar to that used in the 1983 TBS audit. The audit work was carried out by departmental personnel in accordance with guidelines published by TBS and was subject to TBS verification. Of the 11.4 per cent misclassified positions, 7.5 per cent were overclassified. Although a direct comparison with the 1983 TBS audit is not possible, the comparable figures from that audit were 23.8 per cent misclassified of which 19.4 per cent were overclassified.

- In conjunction with the biennial classification audits scheduled for 1988 and 1990, individual departments have been required to establish goals for job classification based on their misclassification rate identified in the 1985-86 audit. These performance targets have been set by all departments with more than 400 person-years; they have also been reported to the Public Accounts Committee.

- Departments are required to submit monthly reports to TBS on actions undertaken to correct misclassifications identified through the 1985-86 audit as well as misclassifications identified through their own monitoring activities.

- TBS will be renewing an agreement with the Public Service Commission whereby the Commission will audit certain aspects of the classification process during its audits of departmental staffing. Where there is evidence of a thorough internal audit of a department's classification processes, TBS will exempt the department from the Commission review of classification in order to avoid duplication of effort.
- Effective 1 April 1986, TBS introduced a computerized information system to monitor departmental classification activity. This system will provide for comparison of individual departmental activity with service-wide norms.
- Through TBS directives, responsibilities for job classification have been clarified with respect to the roles of personnel specialists and departmental managers. Personnel specialists attest to the correctness of the classification decision; departmental managers attest to the cost implications and availability of funds. TBS has also directed that proposals for reorganization must be approved in departments by managers who are at least two levels above the positions affected by any proposed classification action. Departments have been informed that the classification performance of managers is an integral part of their performance appraisal. Where a department's classification program is unsatisfactory, the deputy head will be called before the Treasury Board to explain plans for corrective action.
- TBS is closely monitoring the action undertaken by departments to correct misclassification.

Accountability for Job Classification

15.35 Our recommendation in this area called for Treasury Board to report periodically to Parliament outlining the activities and performance of the job classification system. In the course of testimony before the Public Accounts Committee, the Secretary of the Treasury Board indicated that the President of Treasury Board would abide by the wishes of the Committee with respect to a report to Parliament on job classification. The Public Accounts Committee did not decide formally on this recommendation. The members who spoke on the issue were prepared to wait for the April 1986 report of TBS to the Committee to decide on a final disposition of the recommendation. A recommendation for a report to Parliament has not been made.

Conclusion

15.36 In our view, Treasury Board and its Secretariat have taken strong and direct action to address the problems identified in our 1984 audit of job classification. We are concerned, however, about the pace of the TBS review of outdated classification standards. TBS undertook to review and update 50 classification standards by 1 April 1987. TBS informs us that all the standards are now in the process of review and that six have been completed. We appreciate that the task is difficult and the time frames tight; nevertheless, in view of the TBS commitment to the Public Accounts Committee, we suggest that the Treasury Board Secretariat monitor the situation closely.

15.37 The results of TBS's 1985-86 service-wide audit of job classification indicates that TBS measures are having a positive effect. In view of these results, and the TBS estimate that the rate of misclassification will drop to 6.4 per cent service-wide in 1990, we believe it is appropriate that a report to Parliament on job classification be put on hold until the results of the 1988 and 1990 audits are known and have been subjected to verification by this Office.

Canadian International Development Agency - 1984, Chapter 9

15.38 Our 1984 comprehensive audit of the Canadian International Development Agency (CIDA) reviewed four main program components: food aid, bilateral aid, multilateral assistance, and special programs. The report concentrated primarily on food aid and bilateral aid. We made several recommendations with respect to accountability for results, roles and responsibilities, planning, monitoring, technical support, procurement, the use of evaluation findings, human resource planning, and Agency management.

15.39 The Public Accounts Committee held four hearings on CIDA. In its Eighth Report to the House, tabled in October 1985, the Committee made eight recommendations to the Government and CIDA.

15.40 In our follow-up of the 1984 audit, we reviewed the actions taken by the Agency to ensure that changes had been made in line with the recommendations. We also reviewed the reports prepared for the Public Accounts Committee. We discussed system changes with management and reviewed relevant documentation. Our follow-up procedures did not include detailed project file reviews or on-site visits to projects, and therefore we cannot conclude on the results of the system changes that have been introduced. Our review addressed food aid, bilateral aid, human resource planning, evaluation, and Agency management issues.

15.41 CIDA has made a serious effort to address the recommendations resulting from the 1984 comprehensive audit and has made significant progress in most cases.

Food Aid

15.42 Our 1984 Report stressed the need to re-examine the organization, administration and accountability of the food aid program. We observed weaknesses with respect to information on food needs, monitoring of delivery and distribution, evaluation, and the procurement of skim milk powder.

15.43 We also expressed concern over the diffusion of accountability for the program. The Public Accounts Committee recommended that the Government establish CIDA as the clear, overall program manager for the food aid program.

15.44 **Accountability.** Since 1984, CIDA and Supply and Services Canada have executed a memorandum of understanding on procurement that covers their respective responsibilities pertaining to the procurement of food and transport. The Government reaffirmed to the House of Commons, Agriculture Canada's lead role for the World Food Program and stressed the value of maintaining a close linkage and flow of information between the food aid program and the Canadian agricultural sector. CIDA, however, is accountable for the overall management of the food aid program and seeks the advice of other departments when developing food aid policy.

15.45 While no formal agreement, covering dealings with the World Food Program, has been established between CIDA and Agriculture Canada, CIDA's current operating relationships with Agriculture Canada are working well. Through the implementation of an improved communication system involving the World Food Program and Agriculture Canada, regular reports are now available containing up-to-date information on food aid commitments, shipments and their destinations. This computerized system is still under development.

15.46 CIDA has improved its internal co-ordination of the procurement process and the delivery of bilateral food aid. The Food Aid Co-ordination and Evaluation Centre (FACE) and the Procurement Division have implemented new operating procedures. FACE now provides a Project Resource Officer for all food aid projects.

15.47 **Information on food aid needs.** Since the 1984 audit, the existing information networks have been strengthened. This was in partial response to the crisis in Africa. In addition to meeting regularly with representatives from the World Food Program and the Food and Agriculture Organization, FACE frequently meets informally with the European Economic Communities and USAID. CIDA has contributed funds to strengthen the World Food Program monitoring and delivery systems for multilateral and bilateral aid to Africa. FACE now disseminates more information on food aid needs to the non-governmental organization community.

15.48 **Monitoring.** The Agency has changed the instructions to officers in the field. Guidelines are now in place that clearly specify the work to be done. Monitors are under contract to be present at ports when food shipments arrive and are required to report their findings to the Post. Co-ordination among the various agencies located in the field is also carried out as a result of CIDA's reinforced message on the importance of the monitoring function.

15.49 **Skim milk powder.** The method of vitamin fortification of skim milk powder has been reviewed by the Agency, Agriculture Canada and the Canadian Dairy Commission. The cost of fortification will be brought down to a level comparable with other donor countries. The automated process, which meets Canadian and international standards, is expected to reduce the cost of fortification since it eliminates the need for manual debagging and rebagging of the powder.

15.50 The Agency has recognized the problems associated with using woven polypropelene bags. As of April 1986, the Agency will use the regular 5-ply paper bags that reveal puncture marks and are easier to stack. Regular damage reports are to be filed in the field to record shipping problems.

15.51 Skim milk powder bags are now product dated to determine if the storage period has exceeded the shelf life of the fortified product. The recipient country will now be able to determine other uses, recall, or destroy any stale dated powder to reduce any possibility of harming food aid recipients.

15.52 Although the pricing formula for skim milk powder is fully satisfactory; there is no provision for periodic review by the Agency of the calculation of the price per tonne. CIDA informally maintains an awareness of price movements within the industry as well as the prices paid by other aid agencies. However, no formal record of these other prices is kept by the Agency. Regular review of the application of the pricing formula by CIDA would confirm adherence to Treasury Board requirements.

Bilateral Program Delivery

15.53 **Project planning.** CIDA has taken steps to improve project planning by emphasizing the need to assess factors critical to a project's operational viability and to consider lessons learned from previous projects or phases. It has also introduced measures to reduce the length of time taken between project identification and mobilization.

15.54 The assessment of operational viability has improved through:

- ensuring adequate challenge by bilateral branch project review committees;
- emphasizing the importance of providing for the unforeseen by establishing specific contingency allowances; and
- establishing a "Bilateral Information Feedback System" designed to provide access to evaluation information derived from CIDA's prior projects.

15.55 CIDA projects often extend into second or third phases. In 1984 we found that the lessons learned from previous phases were not regularly considered in subsequent phases. The project approval system has now been modified. Proposals for the second or third phases of projects must use the results of the evaluations of prior phases and similar projects, and show how these will be incorporated into subsequent phases. However, planning and approval documents that we reviewed had no specific references to the evaluation results of earlier phases. How the problems identified in earlier phases would be alleviated or resolved was not evident. The resolution of problems may be implicit in the plan, but explicit reference would provide better information to the approving authority - senior management, the Minister or Treasury Board. The Agency now requires that the Evaluation Division prepare a critical review of the plans for projects that require a CIDA contribution greater than $2 million.

15.56 To reduce the time from project identification to mobilization, CIDA has obtained an increased delegation of authority for project approval, encouraged concurrent planning activities, and reduced duplicate documentation. CIDA also plans to formalize contract planning as part of the project planning framework.

15.57 **Project management structure.** In 1984 we observed weaknesses with respect to roles and responsibilities of project team members and field representatives, monitoring, the provision of adequate technical and administrative support and the use of project evaluations. The Agency has made progress in addressing these weaknesses.

15.58 In view of government policy to constrain the number of person-years while increasing the volume of development assistance, CIDA is considering alternative program delivery approaches. During the past two years, CIDA has increased the level of contracting for project planning and execution to the private sector, non-governmental organizations and institutions. Decision-making authority has been decentralized by giving authority to the Posts to engage local consultants and to manage co-operants. Together with the Treasury Board, CIDA undertook a contract practices review that dealt with contractor accountability, contract definition, monitoring and administration of contracts. Other policy changes may occur as a result of the joint House/Senate review of foreign policy. A report of the Standing Committee on External Affairs and International Trade is expected in 1987. Formal resolution of problems, including achieving a balance between domestic and international objectives, will await consideration of the reports of these Committees.

15.59 In addition to the study on contracting policy, CIDA has taken steps to increase the number of standing offers for technical assistance, to increase the amount spent on monitoring contracts, to establish field support units under contract, and to issue a manual on the establishment of such administrative and technical units. The Agency is examining different possibilities for increased monitoring and decentralization.

15.60 Standing offers, project monitors and field support units provide increased availability of specialist advice in planning, monitoring and evaluating projects. CIDA has increased the number of standing offers with consultants thereby providing the project team in Headquarters with extensive and ready access to specialist expertise in a number of subsectors. Major contracts for project monitors and the existence of technical and administrative support units should ensure better on-site monitoring and reporting to the project team in Headquarters.

15.61 The Agency is seeking Treasury Board approval for additional person-years to ensure that adequate in-house resources are available to manage increased technical responsibilities and to maintain effective contractor accountability.

15.62 CIDA has re-examined the roles and responsibilities of key project team members such as the project team leader, the resource officers, the CIDA representative in the Post, the executing agents and project monitors. The Agency will soon issue instructions clarifying their respective roles and responsibilities for project delivery.

15.63 **Procurement.** In 1984 we found that CIDA needed to strengthen its procurement planning and monitoring. This included the need to improve the Agency's communication of procurement policies, procedures and guidelines to the project teams and consultants. A recently completed internal audit of the Procurement Division indicated that there is now an improved accountability framework. The improvement is due to a new mandate and organizational structure, memoranda of understanding between CIDA and Supply and Services Canada and between the Procurement Division and FACE, written procedures and guidelines, and the preparation of a divisional training plan.

15.64 However, the draft internal audit report indicated that Procurement Division staff "were not included in project planning and monitoring activities to the extent which is dictated by their mandate, and to the extent required to ensure an effective procurement function in CIDA." Although representatives of the Division are usually assigned to the projects that have significant procurement components, these assignments are often made after the procurement mode has been chosen and the detailed plans of operation have been prepared. The internal audit also noted that procurement mode decisions were not substantiated by documented information and consistent analysis.

15.65 A detailed action plan to resolve these issues is being prepared to respond to the recommendations arising from the internal audit.

Agency Management

15.66 **Comprehensive Agency Management Plan.** Progress on completing remaining Comprehensive Agency Management Plan (CAMP) projects has been satisfactory. Of the remaining active CAMP projects, the four major ones, representing 80 per cent of the budget, are now under suitable budgetary control. Scheduled reviews of CAMP projects have been completed and appropriate action has been taken to address outstanding issues. The Comptroller General's Office is validating completed projects.

15.67 **Corporate memory.** In 1984 we examined minutes of the President's Committee dealing with operational issues and noted that no mechanisms were in place to ensure structured and systematic follow-up of Committee decisions. As a result, there were delays in implementing corrective action.

15.68 Since 1984, CIDA has initiated a Corporate Management Initiative Program. Major reports with policy and program implications are channelled through the President's Committee where priorities are set. Action plans are developed by the appropriate branch and incorporated into workplans. Their status is reviewed semi-annually by the President's Committee.

15.69 Recommendations from audit and evaluation reports are considered and approved or rejected by the Audit and Evaluation Committee. In July 1984 the President's Committee delegated the responsibility to the Audit and Evaluation Committee for monitoring the implementation of approved audit and evaluation recommendations. Internal audit recommendations are systematically followed up and status reports are prepared.

However, there are no similar procedures for monitoring the implementation of actions taken to address the approved recommendations arising out of corporate and program evaluation studies considered by the Committee.

15.70 **Evaluation planning.** In 1984 evaluation activity was not being carried out in an integrated and co-ordinated way. Procedures to co-ordinate evaluation activity in the various program branches and to ensure the overall quality of corporate, program and project evaluations needed to be developed. The Agency's Evaluation Division now emphasizes the integration of project and corporate evaluation plans. The Division prepares an annual report on evaluation activities. In addition, the Division issued standard guidelines for planning and conducting project evaluations and developed an evaluation training course for project managers.

15.71 **Human resource planning.** CIDA and its staff work in a changing environment. Externally, the relationships with its client countries are often being redefined. Internally, the Agency undergoes frequent structural, program or administrative changes. These factors have a major impact on the type and level of expertise required, the specific location where these skills are needed to meet operational objectives and when they are needed. The Agency must have mechanisms and information that can permit it to make timely adjustments to meet new demands or orientations.

15.72 In 1984 CIDA's Human Resource Plan was not linked into the operational planning process and there was no multi-year human resource planning. Since then, CIDA has implemented the key elements of a human resource planning system. It provides managers with an integrated planning framework, an adequate data base, a co-ordinated staff redeployment cycle and an articulated career progression process. A Multi-year Human Resource Plan (MYHRP 1986-1990) has been approved by the Treasury Board. The next MYHRP is meant to be included in the Agency planning cycle. The reintegration of staff posted overseas and the redeployment of personnel are now co-ordinated through an annual exercise administered by Personnel and involving every branch in the Agency.

National Energy Board - 1984, Chapter 10

15.73 In our 1984 audit of the National Energy Board, we examined the procedures leading to and supporting the Board's regulatory decisions, particularly the management controls over the analysis supporting these decisions and the technical completeness of the analysis. We also examined the procedures used by the Board to monitor compliance with its decisions and to determine the effects of the decisions. Also included was the Board's administration of the Export Charge program. We identified some weaknesses and made three recommendations.

15.74 We followed up on the three recommendations, bearing in mind the changing environment in which the Board must now regulate. Since the audit in 1984, the Government has been moving toward less regulation of oil and gas exports and pricing. In some cases, this has altered the impact of our recommendations. Our follow-up consisted of discussions with Board staff in the functional branches and a review of supporting documentation. We did not perform a detailed examination.

Pipeline Regulatory Activities

15.75 We recommended that a long-term program should be undertaken to strengthen the Board's efforts to encourage economy and efficiency on the part of the regulated pipeline companies. The Board took three initiatives in its response to this recommendation.

15.76 First, the Board has been considering a concept of "focused management audits", or a type of value for money audit. Progress had been made in this area when the "Agreement on Natural Gas Markets and Prices" was signed in 1985. In this agreement, the federal government agreed to establish an Independent Pipeline Inquiry Panel to conduct an all-encompassing review of the role and operations of interprovincial and international pipelines. Concurrently, the Board was conducting toll hearings respecting two main carriers. Because of these happenings, and recognizing that it was in a transitional period, the Board decided that the time was inappropriate to begin management audits. These audits may begin in the latter part of 1986 or early 1987.

15.77 The second initiative concerns strengthening the Board's cost control over pipeline construction. During initial hearings, the Board has been conscious of the design, routing and cost estimates of major construction projects. Cost estimating and control are now more prominent in these hearings. A standard condition has been included in certificates that requires companies to file monthly cost progress reports and Board staff are examining approved cost estimates and forecast schedules as part of a "cost monitoring program". Any variances between original estimates and progress reports are followed up.

15.78 A third initiative involves improvements to the audit organization at the Board.

Export Charge Administration

15.79 Our other recommendations concerned control of oil exports. Previously, all exports of oil were required to be licensed, and companies paid an export charge on each cubic metre of oil exported. Effective 1 June 1985, the licensing requirement was terminated, as was the Export Charge. These changes had a significant impact on Board operations.

15.80 Our second recommendation was that the Board should determine the amount of oil and bulk products being exported illegally, for example, by truck. We agree with the Board's decision not to implement this recommendation; with the de-regulation of oil exports and the Export Charge set at zero, the need no longer exists.

15.81 Our third recommendation, that the Board should establish whether its current enforcement practices fully meet the intent of the legislation, has taken on a new meaning. Under de-regulation, the Board's audit function as it relates to Export Charges will be terminated when planned audits are completed. Our 1984 audit found that the Board had not adequately evaluated the scope and extent of testing done of oil companies to improve the effectiveness of the Export Charge audit function. We reported that the Board had not assumed responsibility for ensuring that all exports are reported to the Board. Until recently, there has been a lack of information on previous assessments and audit findings on which to base audit planning. The Board now plans to re-examine the extent of audit testing to be performed as results of current audits become known. We agree with this approach.

Overall Conclusion

15.82 The Board's efforts to address our recommendations have been tangible and realistic. However, because each of the initiatives has been taken relatively recently and action is still under way, we will consider further follow-up.

Department of National Defence - 1984, Chapter 12

Background

15.83 Our second comprehensive audit of the Department of National Defence (DND) was reported in Chapter 12 of our 1984 Report. This audit comprised six lines of enquiry: planning, control and evaluation; financial management and control systems; major equipment acquisitions; facility construction projects; automated data processing (ADP) systems development; and human resource management. There were 29 recommendations in the chapter that spanned these six lines of audit enquiry. The Public Accounts Committee devoted three sessions during February and March of 1985 to the chapter and, on 30 April 1985, it put forward a number of recommendations in its Third Report to the House of Commons.

15.84 Our follow-up activities were designed to assess the progress that has been made by the Department in carrying out the recommendations put forward by the Office and the PAC. We have divided the activities into two stages. For the purposes of this report, we have provided an initial assessment of progress. In 1987 we will undertake a more detailed examination.

Developments to Date

15.85 The Department agreed with all our recommendations. In some cases, the Department indicated that steps had already been taken in the direction desired. In a few cases, it was pointed out that factors external to the Department constrained its ability to effect the needed changes. In all areas, however, the Department assigned responsibilities for addressing each recommendation, established action plans, and installed a monitoring system to report internally on progress on a quarterly basis.

15.86 The Third Report of the PAC contained eight recommendations directed toward identification, measurement and reporting of non-military objectives associated with major capital projects; the determination and disclosure of life-cycle costs associated with major capital projects; dual-sourcing of spare parts for the CF-18; and the designation of a senior official to be chief financial officer and comptroller. The Committee asked DND to report back to it with respect to these recommendations by 31 July 1985. It further requested that the Department prepare progress reports on automated data processing (ADP) and internal audit, and submit them to the Auditor General for review on behalf of the Committee by 30 August 1985.

15.87 On 23 July 1985, the Department submitted its report to the Committee and to us. On 30 August, we reported to the Committee that progress in the areas of ADP and internal audit, while preliminary, appeared to be satisfactory.

15.88 On 6 February 1986, the Deputy Minister and the Chief of the Defence Staff were briefed on the scope and direction of the comprehensive audit of the Department that is scheduled for reporting in 1987. During this briefing, they were advised that follow-up on the 1984 Report and the Public Accounts Committee's Third Report recommendations would be carried out in the two stages described above. On 26 March 1986 we requested a status report on progress which the Department provided on 18 April.

Overall Assessment

15.89 The Department has moved aggressively in addressing the recommendations. Of the 37 recommendations (8 from the Public Accounts Committee and 29 from our Office) requiring a change in management systems or practices, action is reported as complete on 15; another 2 are awaiting final approval. Eighteen are being addressed, while another two are inactive until other decisions are made.

15.90 Our preliminary review of progress has led us to conclude that, in most cases, the response by DND has been thorough and properly directed to addressing the factors that led to a need for change. In many areas the issues involved are very complex, and it will be some time before the full effects of the Department's actions are known.

Summary by Line of Enquiry

15.91 **Planning, control and evaluation.** As we indicated in our 1984 Report, an approved peacetime force structure for the longer term, with an appropriate link to wartime requirements, is needed to guide the planning and management of virtually every aspect of the Department's activities. During the audit, the Department initiated a Normative Planning Project to determine peace and war requirements. Since our 1984 Report, activities in this area have been broadened and deepened into what is now called the Defence Policy Implementation Process.

15.92 In the latter part of 1985, the Minister of National Defence issued guidelines for a defence policy review which resulted in the formulation of defence policy options including " illustrative, costed, military force structures". An action plan has been established and is ready to be implemented once an option has been selected. If events proceed as planned within the next year, the Department will have defined the longer-term force structure plan called for in our 1984 Report. We will continue to monitor progress in this very important area.

15.93 The Department has moved quickly in response to our recommendations concerning feedback mechanisms. A Chief of Review Services (CRS) position has been established, reporting to the Deputy Minister and to the Chief of the Defence Staff. CRS has the task of, among other things, co-ordinating feedback mechanisms. A new operational readiness reporting system has been put in place. As well, steps have been taken to ensure that comprehensive Canadian exercises are regularly scheduled by the Chief of the Defence Staff. However, many challenges still face the Department in this area. For instance, the relationship between the responsibilities of the CRS and those in the line chain-of-command has yet to be resolved. We will continue to monitor developments in this area.

15.94 **Financial management and control systems.** A satisfactory report on progress in the area of internal audit was provided to the Office for review on behalf of the Public Accounts Committee. Responses to the recommendations dealing with establishing an internal audit policy, plan and quality assurance function have also been satisfactory. Steps have also been taken to expand the scope of audit activity. Work is under way to put forward a departmental position on the comptrollership function.

15.95 **Major equipment acquisitions.** The Department has issued guidelines relating to concepts of operating new equipment items, reporting changes to project scope or cost, and project management procedures. Our future audits will examine compliance with these guidelines. Work continues on developing new information systems to improve capacity definition, efficiency measurement, work standards, cost information and performance measurement for maintenance facilities.

15.96 The Department undertook a review of alternatives to fixed-ceiling funding for major equipment items still in the development stage, and concluded that, given fiscal constraints, a funding ceiling provides necessary management discipline. This recommendation is linked, however, to the recommendation that changes in project scope or cost should be reported to the appropriate authorities. If ceilings must remain inflexible despite unit cost increases resulting from technological or design changes, then care must be taken to ensure that the necessary adjustments to the number of units or necessary support items acquired are understood and reported.

15.97 DND has devoted considerable attention to addressing the need for consistently applied life-cycle costing of major capital projects. Discussions on this are under way with officials from Treasury Board and the Office of the Comptroller General, and a decision is expected soon on the categories of costs to be reported.

15.98 Non-military objectives (e.g., industrial development, regional growth, research and development, employment) associated with major defence purchases are often difficult to quantify, cost or, indeed, separate from defence objectives. The Public Accounts Committee noted, however, that these non-military objectives play a role in justifying extremely large expenditures. In many instances, their attainment can significantly increase project costs. The Committee, therefore, felt that it is necessary to identify, measure and report the attainment of non-military objectives.

15.99 The Department is now finalizing the procedures needed for identifying and reporting non-military objectives. Part III of the 1987-88 Estimates will contain a description of non-military objectives anticipated for all major Crown projects, along with a report on the achievements of a selection of these projects.

15.100 **Facility construction.** The Department has established procedures for performing post-completion evaluations of construction projects.

15.101 **Human resource management.** Action related to recommendations dealing with balancing training commitments and resources, identifying training needs emerging from major capital projects, investigating the use of new training technology and identifying civilian training needs has been completed in a satisfactory manner. Progress is under way to integrate the various personnel functions and to improve the personnel management information system. Once again, progress in these areas appears to be satisfactory. Although little progress has yet been made on the redesign of the classification and trade structure and on the identification of civilian resource requirements we anticipate that work will proceed in these areas as major components of the long-term force structure plan.

15.102 **Automated Data Processing (ADP).** Progress is satisfactory in all the areas of role definition, planning, costing, performance monitoring and survivability planning. A departmental ADP strategy has been approved, long-and short-term national level plans have been produced, with Command and National Defence Headquarters Group plans having been produced or in process. Performance monitoring and ADP resource accounting have been enhanced, improving managerial control and providing feedback to planning. Planned equipment upgrades have occurred and major systems development is progressing. A survivability plan for the national-level facilities has been produced implementing the departmental ADP Survivability Policy. Disaster Response Plans are being drafted.

Department of Public Works - 1984, Chapter 13

Introduction

15.103 Our 1984 comprehensive audit of the Department of Public Works (DPW) focused on the Accommodation Program, but extended to other key operations and activities including IMPAC/revenue dependency, the Marine Program and the Professional and Technical Services Program. We identified many serious problems in the management of accommodation and the lack of cost-consciousness in the expenditure of public funds. We made 15 recommendations.

15.104 At the time of our follow-up, a review of progress with respect to the Department's Management Improvement Plan was being carried out by the Office of the Comptroller General and DPW's Management Improvement Branch. We decided to rely on their work to the extent we considered practicable. Our review consisted of discussions with representatives from functional branches at DPW's headquarters and three regional offices, as well as a review of pertinent documents. We did not perform a detailed audit.

Developments to Date

15.105 The Public Accounts Committee held hearings in February 1985 to discuss the audit report on DPW. The Committee subsequently issued a report on 1 April 1985, criticizing, among other things, "Treasury Board's failure to enforce its rules, and the inept and ineffective reporting practices between the Department and Treasury Board". The PAC report also made six recommendations. In response to them, the following events took place:

- In May 1985, the Minister of Public Works and the President of the Treasury Board provided written responses to the Committee indicating that specific actions had been taken.
- On 30 July 1985, the Department provided our Office with a progress report concerning management of accommodation. The Department stated that it had decided to address in one comprehensive Management Improvement Plan (MIP) the observations from our 1979 and 1984 Reports, the PAC Report, the IMPAC/revenue dependency plan and the Department's internal audit reports.
- In August 1985, we advised the PAC that all the recommendations contained in its Report and those contained in our Reports had received serious study by the Department. However, although implementation of the MIP was under way in certain areas, it was too early to assess its success. Consequently, we did not carry out tests on the outputs resulting from the new systems, policies and procedures.
- In October 1985, the Department provided us with the first six-month progress report on the implementation of revenue dependency and the establishment of an effective cost accounting system. DPW indicated that it was proceeding, incrementally, to put in place the infrastructure necessary to support revenue dependency, pending a final direction by the government.
- In November 1985, in view of an impending policy statement as a result of consideration of a report by the Nielsen Task Force on Program Review that would have a major impact on the Department in terms of its mandate and particularly the area of revenue dependency, we suggested to the PAC that we would provide an assessment of the above progress report, together with a second six-month report, as of 31 March 1986.

15.106 On 21 November 1985, the Department appeared again before the Public Accounts Committee and presented a detailed progress report on the actions taken with respect to the Auditor General's and PAC's observations. The Committee said it was pleased with the efforts of the Department.

15.107 As a result of the Nielsen Task Force study on real property management, the government, in December 1985, announced new measures to improve management of the federal government's real property holdings. The new approach will also streamline DPW's custody role in the management of general purpose properties, and augment its common service role in providing operations and maintenance, architectural, engineering, real estate and contracting services.

15.108 In May 1986 the Department provided us with the second six-month progress report, effective to 31 March 1986, on its progress in implementing the infrastructure necessary for revenue dependency. We subsequently provided the PAC with an assessment of the report, described later in this section.

Overall Conclusion

15.109 We found that all our recommendations had received serious study, and a total of 64 action plans had been developed by the Department to address the Auditor General's and PAC's observations and recommendations. Despite cuts in resources and adjustments to programs, and a freeze on discretionary spending in February and March 1986, improvement has been made in many areas. Thirty of the 64 action plans are fully complete. A number of action plans were behind schedule, but most of them were substantially in progress.

15.110 Although essential elements of key management information systems have been introduced and the necessary infrastructure for revenue dependency is gradually being put in place, these information systems are neither fully operational nor satisfying user needs.

Accommodation Program

15.111 **Leasing.** To encourage compliance with existing Treasury Board policies, DPW has sent letters to all its regional offices and client departments stressing adherence to Treasury Board policy on lease tendering. The Department indicated that 18.4 per cent of its leasing transactions were publicly tendered in 1985-86, compared with 6 per cent in 1984-85. The rest were carried out in accordance with section 8 of the Government Contracts Regulations.

15.112 **Lease-purchase arrangements.** In response to our recommendation, DPW has disclosed the particulars of lease-purchase arrangements in Part III of the Estimates since 1984-85.

15.113 The authority to enter into a ground lease with a developer has now been clarified; amendments have been made to the relevant statutes.

15.114 In 1984 we noted that there were conflicting legal opinions given to DPW regarding the borrowing done to finance the lease-purchase transactions. DPW legal services, in collaboration with the Department of Justice, is of the opinion that lease-purchase transactions to date do not constitute a borrowing under section 36 of the Financial Administration Act.

15.115 **Managing space.** A national program to dispose of surplus properties was announced in April 1985. Phases 1 and 2 of the program have resulted in the sale of over 200 properties, for which proceeds totalled some $50 million. The Department has provided information on the current status of the properties that the PAC expressed specific interest in, including Block 56 in Vancouver; the Daly Building, the Teacher's College, the Mulligan Building and Canlands in Ottawa; the parcel of land in Downsview; and the Dominion Public Building in Toronto.

15.116 The first phase of the Facilities Inventory System (FIS) has been implemented to provide basic inventory data and information on space occupancies. The Occupancy Instrument (a formal, written agreement concerning accommodation provided) is the prime data input to FIS. Slippage has continued to occur in signing these documents by client departments; the Department expects completion by the end of 1986-87.

15.117 A new classification of vacant space has been developed in an effort to manage the inventory better. This new classification has indicated that some 374,465 square metres of vacant space exist in an inventory totalling 6,775,000 square metres. DPW reports that only 131,302 square metres of vacant space are marketable. That represents 1.9 per cent of total space. For 1985-86 the Department targeted 120,930 square metres of vacant space to be occupied or disposed. They report 124,480 square metres achieved. Initial efforts to do a complete reconciliation of the data have been delayed because the definition of "vacant space" and interpretation of data are not yet consistent in all regions. The Department is also working toward space optimization. In this respect, it has experienced problems in defining space optimization and interpreting data. The Department reports some 26,100 square metres achieved against the 1985-86 target of 27,750 square metres.

15.118 Phase two of FIS, which is designed to provide planning data for input to the Department's management processes and the Multi-year Operational Plan, is partially operational in some regions. Some enhancement to the system is required; it is being planned for 1986-87.

15.119 **The budgetary process.** A new work planning and budgetary control process was introduced in 1985-86, and targeted for automation in 1986-87, to ensure that plans are linked with budgets and that variances are reported and acted on promptly.

15.120 DPW regional offices have completed the 1985-86 program of facilities inspection to ensure that work plans include all the work necessary to achieve a predetermined level or quality of maintenance.

Marine Program

15.121 As directed by Cabinet, DPW has pursued various options to dispose of the dry docks. The principal dry dock users were invited to submit proposals, but no satisfactory bids were received. The Department has recently suggested other courses of action to Treasury Board and is waiting for direction.

Services Program

15.122 Time reporting systems for realty management services and real estate services and phase one of the Time Reporting/Project Monitoring System for architectural and engineering services have been implemented. However, the time reporting systems for realty services do not capture operational planning and project control data. The second phase of the Time Reporting/Project Monitoring System is being developed to enhance project management control.

15.123 The Department advised us that a Treasury Board submission had been drafted to present to the Board the results of its studies respecting norms for resource allocation and evaluation, fees for services, and an A-Base Review related to architectural and engineering services.

15.124 The Department also indicated that the role and mandate of the Technology Branch had been clarified and specific initiatives had been planned by DPW to ensure that its regional offices are aware of the Branch's role and mandate.

Revenue Dependency

15.125 As at 1 April 1985, DPW began charging client departments for the direct costs of its services; that is, project disbursements and payroll costs of DPW staff directly performing the work. In December 1985, Treasury Board directed the Department to initiate market rates in the Services Program as soon as possible and to report by 31 March 1986 on the internal mechanisms necessary to introduce the new regime. As of 1 May 1986, no report had been submitted. The Department advises that this is tied to a variety of complex issues related to the government's decisions on real property management. The Department's comprehensive response to the Treasury Board in this regard will include proposals for the implementation of revenue dependency.

15.126 The Financial Management System is one of the key management information systems being implemented by DPW. The first release (FMS I) deals with the provision of the necessary financial accounting information to management and to government while the second release (FMS II) intends to provide the necessary management accounting information. FMS I was implemented in 1985-86 and is close to fully operational. However, we noted a number of problems with this system. DPW advises us that a private sector study to assess the current status of the system has been carried out and recommendations are now being implemented.

15.127 FMS II addresses the cost accounting requirements of the Department and provides other financial information for management. The target completion date is April 1987.

15.128 In our opinion, progress has been made by the Department in implementing revenue dependency for its Services Program. However, the Department has not indicated a firm time frame for introducing market rates for the Services Program. In compliance with

Treasury Board direction, the Department, jointly with the Treasury Board Secretariat and the Office of the Comptroller General, is immediately to assess the viability of the systems and internal mechanisms necessary for its operation and its readiness (including impact on its clients) regarding the implementation of revenue dependency based on market rates. The Department advises us that it will be making a submission to Treasury Board by 31 October 1986 concerning the introduction of revenue dependency for both its Services and Accommodation Program.

Secretary of State - 1984, Chapter 14

15.129 Our 1984 audit covered all the major operational sectors of the Department of the Secretary of State: education support, translation and citizenship registration.

15.130 At that time, we identified weaknesses in the management of Translation Bureau operations as well as in the control over the development of a new loans system for the Canada Student Loans Program.

15.131 This follow-up report is limited to those two areas and is based on interviews with managers from the four branches of the Translation Bureau as well as officials of the Canada Student Loans program, which is part of the Education Support Program. We were able to obtain and examine the available information that was relevant to our task. However, we did not conduct a detailed audit of these programs.

15.132 We observed that the Secretary of State has adopted corrective measures in response to each of our recommendations. At the time of our audit, the changes resulting from these measures had been implemented only recently or were just being implemented.

The Translation Bureau

15.133 **Strategy for deploying resources.** As a first step in developing a strategy for an optimal balance between the use of in-house resources on one hand and the use of translation firms and freelance translators on the other hand, the Bureau established an acceptable, accurate methodology for determining its in-house costs. The methodology was then assessed by outside consultants that concluded that it was a valid management tool.

15.134 The data from this new source of information will provide one of the significant elements on which to base a make-or-buy policy. This second step should be achieved during the first half of fiscal 1986-87.

15.135 **Monitoring productivity.** Following recommendations from the task forces assigned to look into the issue, senior management decided to adopt a new philosophy of management. It is oriented toward the results that are to be achieved, recognizes the value of professional contributions to translation services, and emphasizes the management abilities of translation service directors.

15.136 Instead of adopting a Bureau-wide quantitative standard to be used as a performance benchmark or as a criterion in promoting translators, the achievement of results related to objectives approved by senior management will become the basic element in evaluating both management and employee performance.

15.137 The principal steps in introducing this new management approach are as follows:

- simplifying the administrative structure and increasing the authority and responsibilities of translation service directors;
- improving the overall existing planning system for translation services, allowing management to identify all translation activities to be undertaken and to set production objectives for each activity; and
- developing an operational information system to give managers the information they need to assess the achievement of objectives.

Detailed work plans were produced for the first time for fiscal 1986-87, and the operational information system should be in place by August 1986.

15.138 **Control of workload.** The production control unit set up to control the workload in July 1984 has not produced the desired results. After a trial period of several months, the system was abandoned because delays in producing the necessary information meant that control could not be exercised effectively.

15.139 Senior management hopes that the monitoring methods and rapid access to information offered by its new management approach will solve the problem of how to apportion the workload. As well, the Operational Planning and Co-ordination Directorate will be responsible for comparing forecast with actual production at regular intervals. The Directorate will analyse any discrepancies and report to the Translation Operations Branch, which should be in a position to identify problems and take corrective action.

15.140 **Service to clients: Standards of quality.** In 1985 and 1986, 300 translators attended seminars designed to increase their awareness of the importance of maintaining high standards of quality.

15.141 In April 1986, senior management approved a less rigorous standard of quality regarding the acceptability of the texts. However, it set up an improved quality control system.

15.142 One of management's objectives for 1986-87 is that at least 90 per cent of texts be of sufficient quality that they can be sent to clients as is or with only minor revision. To achieve this objective, a plan is to be completed during the current fiscal year.

15.143 **Meeting deadlines.** With the establishment of the operational information system in August 1986, translation services directors should be in a position to monitor progress on texts being translated. They will be responsible for following up to determine the reasons for missed deadlines and for taking steps to eliminate them.

15.144 The objective set by the Translation Operations Branch is that at least 80 per cent of texts be produced within the time specified; the operational information system will keep the Branch informed about the extent to which this is being achieved.

15.145 **Human resource management: Resource planning.** During 1986-87, the Bureau expects to complete implementation of a data bank containing the information needed for human resource planning for the whole organization.

15.146 As well, a multi-year human resources plan was prepared for the first time in 1985-86. It took account of the Department's operational objectives in a very general way.

15.147 The detailed work plans, introduced in April 1986 as part of the new management approach, also allow identification of human resource needs within the various translation services directorates. However, there is no means of collecting and putting this information to use as the basis of action plans for the Bureau as a whole.

15.148 **Management roles and responsibilities.** The Translation Bureau has clarified management roles and responsibilities. A new organization chart was drawn up in March 1986, and the mandate of each part of the Bureau was defined, along with its functional authority and relationship, if any, with other parts of the Bureau.

15.149 **Promotion criteria for translators.** The Bureau approved a new promotion policy for the TR group in 1985-86. The new guidelines and procedures define and introduce an element of uniformity in the practice of promotions to the TR-2 level.

15.150 This policy is relatively new and, at the time of our audit, the Bureau had not yet had occasion to apply it, because of the staffing freeze intended to reduce the size of the Public service.

The Canada Student Loans Program

15.151 **Correction of data in current system.** The Secretary of State reviewed the data in its computer files and, where possible, corrected or purged them as necessary. A final sifting will be conducted before the data are converted for use in the new information system. The Secretary of State recognizes that internal control of its current system is weak and expects that the system now being developed will correct this.

15.152 **Monitoring progress on system development project.** After completing the conceptual stage for the new system at a cost of five years' effort and $2 million, the Secretary of State began actual development of the new student loans system in April 1984.

15.153 Numerous problems encountered in the development period have caused delays and cost increases. The sources of these problems are several, some of them outside the control of the managers responsible for the projects. We identified the following as the most significant sources of problems:

- The Secretary of State did not take full advantage of the planning and monitoring tools at its disposal. As a result, those concerned consistently underestimated the complexity and scope of the system being developed. For example, the project completion date was pushed back five times, without any thought being given to the adequacy of overall planning of the project, and the programming stage was begun before the detailed conceptualization had been fully approved by system users.
- Communication between users and the development group was not entirely effective. On several occasions, the development team considered that intermediate decisions had been approved by users when in fact this was not the case.

15.154 This had the following effects in practice:

- The date for putting the system into operation was February 1985, but the system was still not operational by June 1986. We were told that the new target date was October 1986, which, according to the original schedule, is a delay of 20 months.
- The actual cost of the system will surpass $3 million, a 172 per cent increase over the original estimate of $1.1 million.

Program Evaluation - 1983, Chapter 3

Purpose

15.155 In 1983 we observed that the quality of program evaluation studies needed to be improved. We have followed up on some key aspects of this matter.

Developments Since 1983

15.156 In 1985 we followed up on two of the issues raised in 1983. First we found that, overall, the annual number of corporate program evaluations had remained stable for the 18 departments examined. Second, we found that 11 of 15 departments examined had reported one or more of their studies in Part III of the Estimates.

Scope

15.157 This year's follow-up looked at program evaluation reports and focused on the quality of evaluation studies. We examined the presentation of evaluation studies, the coverage of evaluation issues, the quality of the evaluation methodology and the trustworthiness of the reported findings.

15.158 Our audit was restricted to an analysis of the report documents supplied to us by the departments. This was sufficient to arrive at a judgement of the reliability of the information. A basic standard for preparing reports is that they should contain sufficient detail, including discussion of limitations and constraints, to allow the reader to make an independent assessment of the value of the information.

15.159 We did not examine utility - the extent to which these studies contributed to significant program change or gave management assurance that change was unnecessary. For many of these studies, it is too early for this kind of empirical data to be available. Utility is the ultimate test of the value of a study; however, reasonable technical quality and trustworthy reporting are essential prerequisites to it.

Criteria

15.160 The basic criteria we use in auditing program evaluations are based on the criteria approved by the Public Accounts Committee in 1980 and the *Guide on the Program Evaluation Function* issued by the Comptroller General in May 1981.

Sample

15.161 A probability sample of 25 studies was selected for audit from a list of corporate evaluation studies completed in 1984-85. An initial review of this list found a number that did not meet all of the criteria for inclusion in the audit. A review of the remainder showed that some did not meet one of our criteria for program evaluation - that a material portion of the study dealt empirically with at least one of the four classes of evaluation issues. The result was a non-probability sample of 16 studies that were audited.

Quality of Program Evaluations

15.162 Based on our audit experience, it is our opinion that, since 1983, there has been an improvement in the quality of study methodology and reporting program evaluations.

15.163 We found 6 of the 16 to be fully satisfactory in both the appropriate application of technique and the clarity and probity of reporting. Two of these studies were particularly well done. There was a second group of six that, while varying significantly in quality, represented acceptable responses to the problems that they tackled. In general, they were studies that provided reasonable information on most of the matters addressed, but they were deficient in differing degrees because of failures in methodology, reporting, or, in some instances, both. Thus, 12 of the 16 studies met a minimal standard of adequacy in their application of evaluation technique and in the way in which they were reported. Many were much better than that on either or both counts.

15.164 Four of the studies were unsatisfactory in their evaluation methods and/or reporting. Although there was also variation in quality within this group, all were found to have serious deficiencies.

15.165 The six fully satisfactory studies were well designed and carefully implemented. Any implementation problems were clearly stated. They were organized so the reader was led clearly from issues through the data to the conclusions about the issues. They were well documented. Typically, these studies presented results that could be related back to the program and offered information well targeted to the study issues. They brought together data in response to each issue, providing a full, reliable, and highly informative answer to each of the study questions. When methodological problems were observed in these studies, they were minor. These studies were unbiased and their conclusions were logical and based on sound argument.

15.166 The six acceptable studies in the middle group each had at least one serious deficiency. However, because they contained much reliable information potentially useful to departments we considered them as at least minimally satisfactory. But they did not meet one or more of the important criteria set out for quality evaluations and therefore could not be accepted as within the standard desirable for government program evaluations. At one end were the studies that were well designed and implemented. Their most typical fault lay in a biased presentation of their findings. Their summaries tended to be selective in the findings highlighted (often bringing forward only the positive findings). At the other end were studies that provided some useful information but missed providing reasonably complete answers to questions. These tended to address only superficially one or more of the issues assigned them.

15.167 The four unsatisfactory reports were poorly organized, poorly documented and poorly written. They often lacked such essentials as a program description or a context for the study. It was difficult to know what points were being made; often the only way to find out was to divine the information from examining the data. The findings in the unsatisfactory studies were often unreliable and invalid, because of poor methodology.

15.168 In 1983, we recommended that departmental evaluation units should ensure that evaluation reports fully present study findings in a balanced manner and discuss the implications of limitations in the methods used for the interpretation of the findings. The unsatisfactory studies show that these problems still exist.

Use to Outside Readers

15.169 In assessing the quality of these reports, we were particularly concerned with the value of the report to an external reader. Increasingly it is expected that these documents will be used by Members of Parliament and other groups. Accordingly, the way in which a study is reported will determine its credibility. To achieve credibility, a report should disclose fully the significant elements of the study process and discuss the impact of any deviations from its intended design. The design used has to be plausible in relation to the problem addressed. Sufficient, carefully organized information is necessary to allow the reader to form an independent assessment of the results. Finally, assertions should be supported by evidence and be fully consistent with it.

15.170 It is recognized that, while undesirable, studies not meeting the standards described here could possibly be useful within a department when the content of the program and the study are well known. However, such a report contributes little internally to corporate memory and has little value outside a department.

The Comptroller General's Role

15.171 In 1983, we observed that a strong central monitoring and quality assurance function would be required to support departmental efforts and to ensure the integrity of program evaluation information. Even though the quality has improved, in light of some of the problems identified, including the selection of inappropriate or superficial methodologies and inadequate reporting, there is evidence of a continued need for the Office of the Comptroller General to further strengthen its efforts in these areas.

National Museums of Canada - 1981, Chapter 11

15.172 The major recommendations we made in 1981 dealt with policies, planning and museum functions. We focused our follow-up on these subjects to assess the steps that National Museums has taken since 1981.

Overall Conclusion

15.173 Although some progress has been made, important problems still exist. Corporate policies on research, conservation and certain aspects of human resources management are still to be approved. The collections policy has not yet been defined.

15.174 With respect to planning, clear objectives for each museum and strategies to achieve the overall objective of the Corporation have not been set out.

15.175 In the area of museum functions, there are still serious backlogs in cataloguing collections. There is not always written evidence that acquisition criteria are being followed. Examining the state of collections and taking inventory are not done systematically. Several collections are still housed in inadequate facilities where storage conditions cannot be controlled. Finally, the National Museums have not yet established an order of priority among the collections so that less important collections are not added to at the expense of other collections.

General Management

15.176 **Policies.** The Corporation has developed a number of policies in the last five years, including a publication policy and several administrative policies. However, there is still no overall policy on research, conservation, or on certain aspects of human resource management. The collections policy still does not specify an order of priority among the collections, as well as within each collection, to guide acquisitions, documentation and conservation.

15.177 **Planning.** The Corporation has developed a strategic document, multi-year and medium-term plans and annual work plans. But it has not developed strategies to achieve its overall legal objective, nor has it developed sub-objectives that take into account the raison d'être and individual character of the museums that make up the Corporation.

Museums Functions

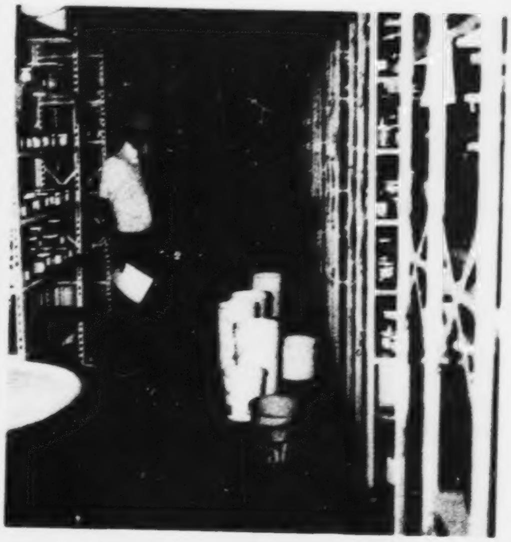
15.178 **Collections policy.** The management principles governing National Museums collections are set out in its Collections Policy, published in 1981. The policy still does not assign an order of priority among the collections or among elements of them to ensure that less important collections do not grow at the expense of others.

15.179 **Acquisitions.** The Collections Policy lists the following acquisition criteria: quality; rarity; historical, scientific or technical value; cultural importance; condition; cost; availability of space; and the use to which an acquisition can be put. We found no written documentation to show that the National Museum of Natural Sciences and the Museum of Man (now the Canadian Museum of Civilization) have applied these criteria. This makes it difficult to ensure that all criteria have been considered and that their collections have been assembled in accordance with established objectives.

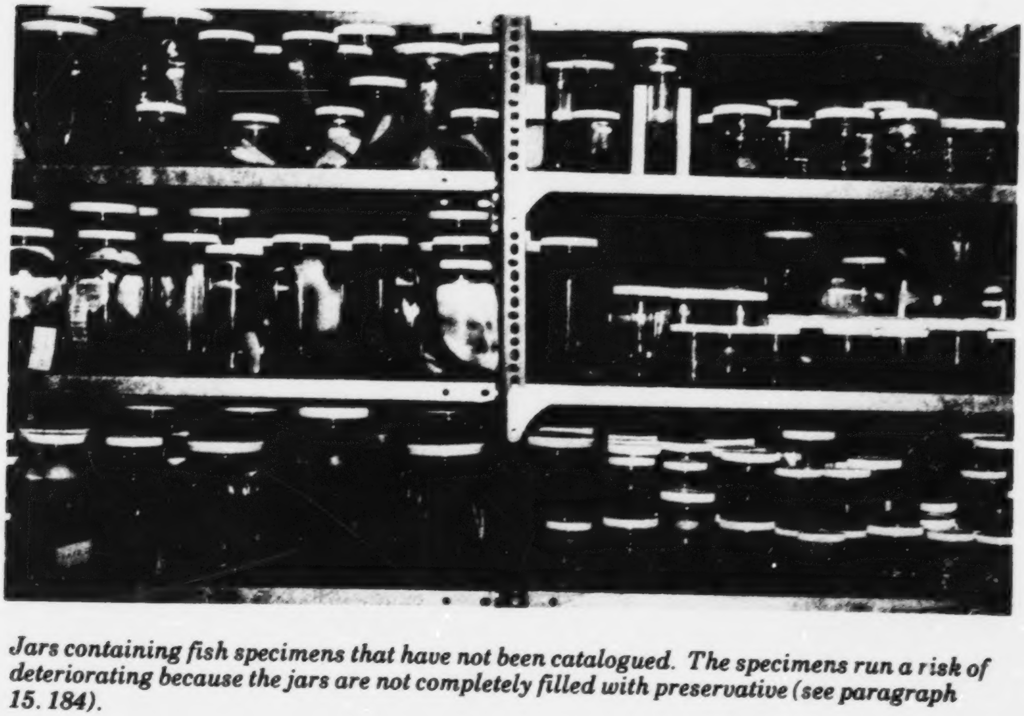
15.180 **Recording.** There are still serious backlogs in cataloguing some collections. Overall, about 600,000 of the 5 million objects in the collections remain to be catalogued. The Canadian War Museum, for example, has catalogued only 10 per cent of its collection. At the current pace of about 1 per cent a year, it will be 90 years before the Museum's present holdings are catalogued. As for entering the items in the Canadian Heritage Information Network, discussed later, the current backlog for National Museums collections alone numbers about 3.5 million entries. Parts of the collections are unavailable for research or display because they have not been catalogued.

15.181 **Controlling.** Objects must be examined periodically to see whether they are in good condition or in need of restoration. The National Museum of Natural Sciences and the Museum of Man do not systematically check on the state of their collections. Good management also requires that holdings be checked periodically against inventory records to ensure that collections are complete. None of the museums takes regular inventory of its collections.

The containers of fish specimens in the centre of the photo were received some seven years ago. The specimens have not yet been catalogued (see paragraph 15.184).



Specimen containers are damaged by water leaking from the roof (see paragraph 15.184).



Jars containing fish specimens that have not been catalogued. The specimens run a risk of deteriorating because the jars are not completely filled with preservative (see paragraph 15. 184).

15.182 **Protection.** Several collections are housed in inadequate facilities where storage conditions cannot be controlled. Although three new museums are under construction, the new buildings will be only a partial solution to the problem of adequate storage. Projections based on the rate of growth in the collections suggest that by the year 2000, the Corporation will still need an additional 164,000 square metres of space – that is, twice the area of the three museums now being built.

15.183 National Museums Corporation has developed an accommodation strategy that sets out criteria for evaluating buildings and includes an evaluation using these criteria. As well it has established multi-year interim and permanent accommodation plans.

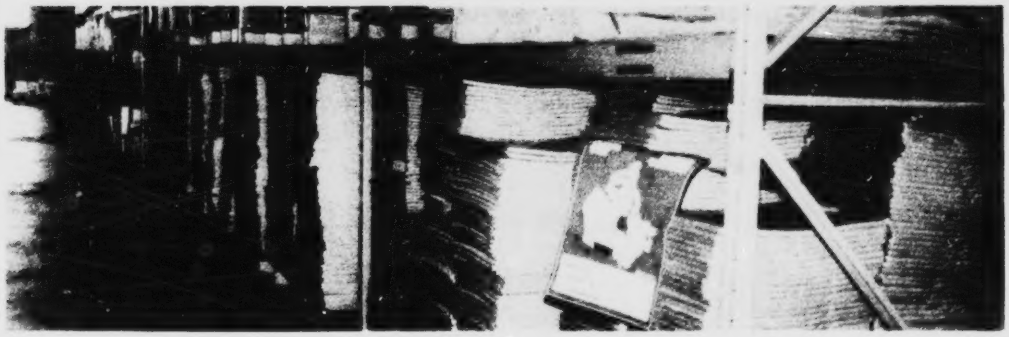
15.184 **Analysis.** Since the Corporation has not established an order of priority among its collections and among the parts of each collection, it continues to acquire all sorts of objects through purchases, donations and excavations. The collections have grown by more than 600,000 items in the past five years. The Museums rarely refuse or reject items donated to them or found at excavations. These then have to be catalogued, restored if necessary, stored, preserved and protected. Items from the collections are seldom disposed of, with the result that as the collections grow, so does the space required to house them and the number of people needed to preserve and protect them. The present situation in National Museums illustrates the point: significant backlogs in cataloguing, insufficient storage and exhibit space, the danger that objects will be lost because of inadequate means of preserving, restoring and protecting them. In effect, it is a vicious circle: the larger the collections, the more inadequate the available resources to catalogue and preserve them, conduct research on them and display them to the public.

15.185 According to Corporation management, it is a lack of resources that is to blame for the cataloguing backlogs, the inadequate control over the state and completeness of collections, and the poor state of buildings. An internal study, whose conclusions were supported in part by a task force chaired by someone from outside the museums, showed that the National Museums Corporation is labouring under a severe shortage of the financial and human resources necessary to achieve its objectives.

15.186 Given the lack of resources, we believe that this situation could be improved by establishing an order of priority among the collections, identifying the collections with the highest priority, and disposing of those of less importance.

15.187 The imminent move of some of the museums' collections to new homes has made Corporation management more conscious of the urgent task of completing the cataloguing of objects already in its possession, restoring some of them, and completing research on them so that they can be moved without risk and new exhibits can be mounted. The move is a good opportunity to begin rationalizing the management of the collections.

15.188 **Research.** We observed that the National Museums Corporation has not established a corporate research policy defining research directions and objectives and overall priorities and setting out project management principles and responsibilities. A draft policy has, however, been prepared for discussion by the Board of Trustees.



There are still 540,000 copies of a free advertising poster about the Museumobiles, printed in the 1970s. Only 3,500 are used each year. The stock on hand will last for the next 150 years (see paragraph 15.196).

MR JACKSON'S
MUSHROOMS
30
ENG

10,000 copies of the book Mr. Jackson's Mushrooms *were published in 1979. 8,000 copies are still in storage (see paragraph 15.196).*

Canadian Arctic Expedition, *published between 1924 and 1928, is the oldest publication in stock. 4,250 copies have not been sold (see paragraph 15.196).*

15.189 In the past two years, the Corporation has set research priorities, an important first step in improving research project management. But priorities are stated in language so general that many projects could qualify. For example, 'The Arctic', a priority identified by the Museum of Natural Sciences, could include projects in the fields of zoology, botany, geology and so on. In our view, research priority areas should be identified more precisely.

15.190 Once approved, a research project can stretch out over several years. We noted that the Corporation does little in the way of monitoring progress on research projects. For instance, projects are not evaluated periodically by independent experts.

15.191 Finally, it is difficult to determine the amount of human and financial resources devoted to research, because the planning and management information systems do not identify them separately. As a result, the overall research budget is not monitored.

15.192 **Exhibitions.** Exhibitions are well planned. Proposals take the expected audience into account, set out costs and schedules, and, after discussion and approval, are incorporated into work plans.

15.193 However, we found that cost projections were not complete because they did not include internal costs such as employees' salaries. In the case of one large exhibition, figures supplied by National Museums showed that the actual costs were as much as four times the amount shown in the budget.

15.194 Finally, the Corporation conducts no systematic evaluation of each exhibition to see whether it has reached its intended audience and achieved its objectives.

15.195 **Publications.** In 1984, National Museums issued a Print Publication Policy. A process was also established to improve publications management – better documented proposals, more clearly defined selection criteria, review and approval of proposals, and use of a management information system. Our examination showed that employees were following established procedures.

15.196 Additional improvements are possible. For example, the Corporation has not set criteria for determining the size of press runs for each publication. It is important to do this because National Museums currently has to store 265,000 unsold publications (350 titles) issued before 1980, some of them dating back to 1924. Obviously, the surplus raises storage costs.

15.197 As well, budgeted amounts do not include costs such as the salaries of employees involved in preparing publications, marketing and so on. The Corporation therefore does not have complete information on which to base decisions about the proposed selling price of publications and their profitability. In the past two years, sales have covered only 33 per cent of the cost charged to publications intended for sale.

15.198 Finally, we observed that the National Museums Corporation does not monitor actual costs against budgeted costs. As a result, it is difficult to tell whether discrepancies are justified and whether they could have been prevented.

The Canadian Heritage Information Network

15.199 The Canadian Heritage Information Network (CHIN) is an automated management information system for Canadian Museum collections. Its purpose is to create a national inventory of collections and facilitate the exchange of information. Participating organizations receive consulting services to help them manage their collections and choose the appropriate technical resources. CHIN now serves 150 Canadian museums.

15.200 Considerable progress in managing CHIN has been made since 1981. Following the recommendations of several studies, the policy governing the program was changed, allowing the Network to offer consulting services concerning the management of collections and information.

15.201 In co-operation with private enterprise, CHIN has installed new software better suited to the needs of the program. A new computer with greater capacity was also acquired to serve clients better. The client list was rationalized by establishing an order of priority among the museums served, based on the significance of their collections. Finally, CHIN has succeeded in recording 25 per cent of the most significant Canadian museum collections.

ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL

ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL

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16

ORGANIZATION AND PROGRAMS OF THE OFFICE OF THE AUDITOR GENERAL

The Office's Responsibilities and Organization

16.1 In contrast to the two previous years, when the Office of the Auditor General was involved in major reorganization required both by changes in its mandate and by the need to improve efficiency, this year has been one of consolidation in terms of the overall responsibilities of the Office and its organization. Nonetheless, the year has seen significant initiatives in several areas.

16.2 It is therefore appropriate to report on the Office's work by emphasizing the areas that are new, expanded or are receiving special attention. After providing a brief review of our mandate, programs and organization, the chapter discusses four important initiatives in which the Office is currently engaged.

Mission, Mandate and Programs

16.3 **Mission**. In considering the scope of his mandate, the Auditor General has stated that his mission is:

- to make independent examination of the accounts of federal departments and agencies and of other entities for which he is the appointed auditor, and to express his opinion on their integrity;
- to make such independent examinations and enquiries as he considers necessary and, based on them, to report on whether or not there were significant deficiencies in the management control systems and practices in the audited entity during the period under examination, thereby providing reasonable assurance, where possible, that:
    - public assets are safeguarded and controlled;
    - transactions are lawful and proper;
    - financial, human and physical resources are managed with due regard to economy and efficiency, and procedures are in place to measure and report the effectiveness of programs;
- to call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, to communicate his findings and observations to management of the audited entity and to make any constructive recommendations he may have;
- to maintain the stature of his Office, share its expertise with Canadian and international colleagues, and contribute to the development of comprehensive audit methodology and practices; and

- to manage his Office with due regard for economy, efficiency and effectiveness, ensuring professional and administrative competence and adherence to applicable government policies.

16.4 **Mandate**. The legislative mandate for the activities of the Auditor General is in the Auditor General Act, 1977, and in the Financial Administration Act, as amended in 1984.

16.5 **Auditing**. Each year the Office conducts audits in all departments and agencies to enable the Auditor General to express an opinion on the summary financial statements of the Government of Canada. Annual audits also assess departmental and agency compliance with legislative authority.

16.6 The Auditor General also conducts value-for-money audits in departments and agencies to fulfil the reporting requirements of section 7(2) of the Auditor General Act. Cases are reported where departments or agencies have made expenditures without due regard to economy and efficiency, or where satisfactory procedures have not been established to measure and report the effectiveness of programs. The Office carries out these audits in each major government entity at least once every five years. In addition, the Office conducts government-wide audits when it is feasible and appropriate to examine issues common to a number of departments.

16.7 **Reporting**. Throughout the audit process, findings are discussed with managers in the entities being audited. At the conclusion of an audit, a formal, detailed report is communicated to the management of the audited organization on the Office's findings, conclusions and recommendations. Finally, matters that the Auditor General identifies as being of concern to Members of Parliament are brought together in the annual Report. In addition, an opinion – together with any reservations the Auditor General may have – is given on the Public Accounts of Canada and included in Volume I of the Public Accounts.

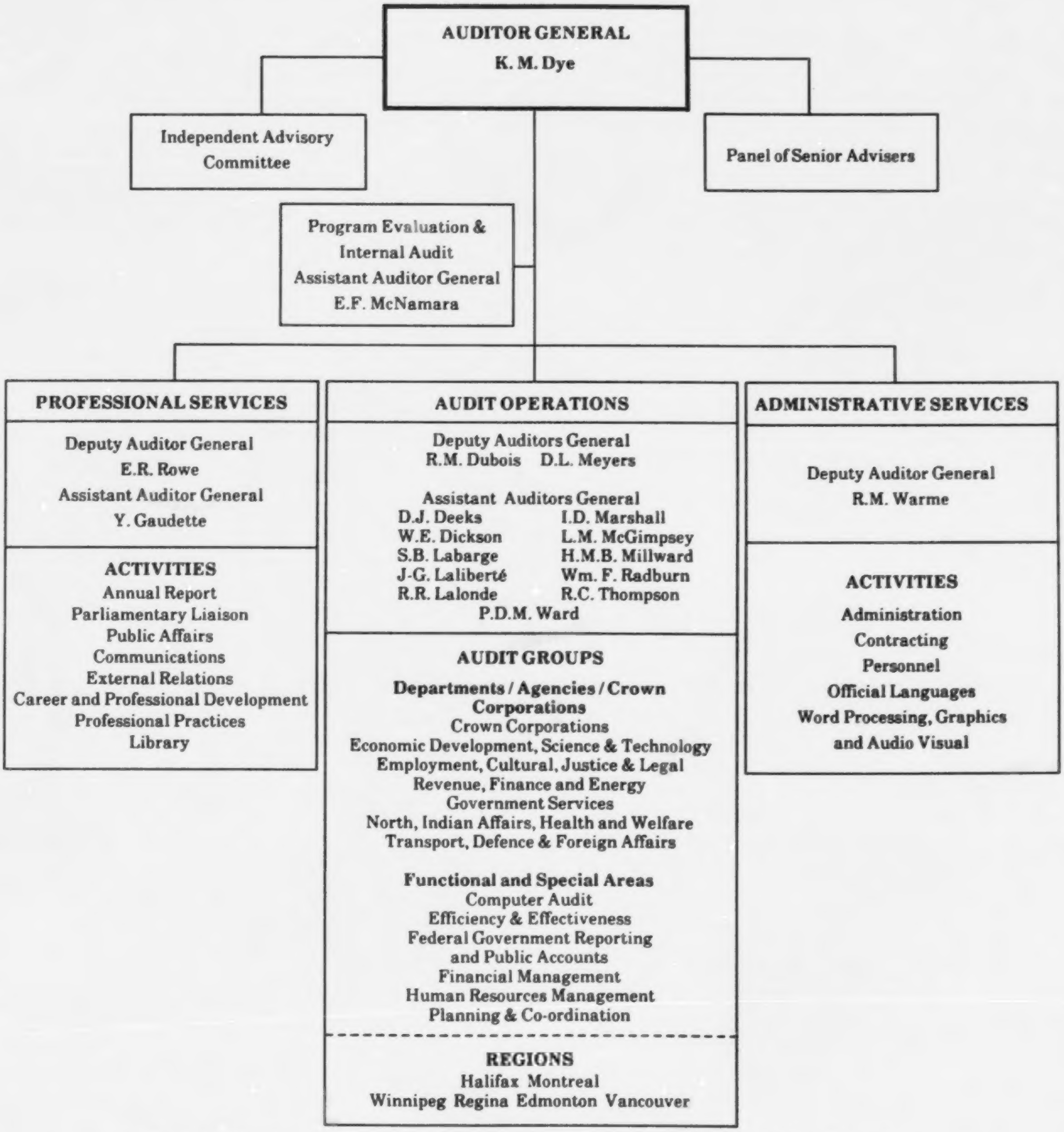
Organization

16.8 Exhibit 16.1 is an overview of the organizational structure of the Office, showing the functions of its three branches.

16.9 **Audit Operations** is the largest branch. It consists of six Department and Agency Audit groups, a Crown Corporations group, five Functional and Special Audit groups, a Planning and Co-ordination group, and five Regional Audit groups. The six audit groups for departments and agencies are each headed by an Assistant Auditor General and each is responsible for a mix of entities that have similar requirements in terms of audit skills and special expertise, or have strong program interrelationships. The largest concentration of auditors is in the National Capital Region; in addition, Audit Operations' work is carried out from regional offices in Halifax, Montreal, Winnipeg, Regina, Edmonton and Vancouver. Personnel also work more or less continuously in Yellowknife and Whitehorse.

Exhibit 16.1

ORGANIZATION OF THE OFFICE OF THE AUDITOR GENERAL
August 1986



AUDITOR GENERAL
K. M. Dye

Independent Advisory Committee

Panel of Senior Advisers

Program Evaluation & Internal Audit
Assistant Auditor General
E.F. McNamara

PROFESSIONAL SERVICES

Deputy Auditor General
E.R. Rowe
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ACTIVITIES
Annual Report
Parliamentary Liaison
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AUDIT OPERATIONS

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Assistant Auditors General
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W.E. Dickson L.M. McGimpsey
S.B. Labarge H.M.B. Millward
J-G. Laliberté Wm. F. Radburn
R.R. Lalonde R.C. Thompson
P.D.M. Ward

AUDIT GROUPS

Departments / Agencies / Crown Corporations
Crown Corporations
Economic Development, Science & Technology
Employment, Cultural, Justice & Legal
Revenue, Finance and Energy
Government Services
North, Indian Affairs, Health and Welfare
Transport, Defence & Foreign Affairs

Functional and Special Areas
Computer Audit
Efficiency & Effectiveness
Federal Government Reporting and Public Accounts
Financial Management
Human Resources Management
Planning & Co-ordination

REGIONS
Halifax Montreal
Winnipeg Regina Edmonton Vancouver

ADMINISTRATIVE SERVICES

Deputy Auditor General
R.M. Warme

ACTIVITIES
Administration
Contracting
Personnel
Official Languages
Word Processing, Graphics and Audio Visual

The Executive Committee is composed of the Auditor General and the Deputy Auditors General.

16.10 **Professional Services** provides professional and technical support to Audit Operations. The Branch reviews, edits and publishes the annual Report and other reports. It is also responsible for providing career and professional development and for liaison with Parliament, public relations, communications, and the Office library. The Branch co-ordinates international activities and liaison with the Auditors General of the provinces. It is responsible for professional practices, including the management of auditing methodology development.

16.11 **Administrative Services** is the Branch that provides central support in the areas of finance, administration, personnel, contracting, official languages and word and information systems.

16.12 While there has been no major reorganization in the Office during the last year, several changes are worth mentioning.

16.13 Following an extensive review, a decision was made to close the Toronto regional office in March 1986. The effect has been to reduce the Office's overall costs and to eliminate duplication of audit activity. In closing the office, great attention was given to the future of the staff members involved. Working closely with other departments, the Office was able to ensure that all personnel satisfactorily pursued their careers or, as in one case, retired.

16.14 The past year also saw the full implementation of the Office's clean air policy. This highly successful program to establish a non-smoking work environment has received high commendation from health authorities and many other groups in the health field. Our policy and program have been widely copied by other organizations.

16.15 The Office remains active on the international scene. The fellowship program, funded by the Canadian International Development Agency (CIDA), continues to bring senior auditors from developing countries to work and study in the Auditor General's Office. Also with CIDA funding, Office personnel are carrying out significant audit and audit training projects in China and the Caribbean. The Auditor General chairs the United Nations Panel of Auditors. Important audit advice is currently being provided by the Office to the North Atlantic Treaty Organization. Working with the International Organization of Supreme Audit Institutions, the Office has spearheaded a major new training initiative to assist developing countries to improve their auditing and accounting skills.

16.16 A major initiative involving all branches has been the total revision of the Office's Comprehensive Auditing Manual. Now in a convenient three-volume compact format, the Manual reflects state-of-the-art comprehensive auditing practices.

Financial Resources

16.17 In Part III of the Estimates, the Office has provided its detailed resource requirements to Members of Parliament. Exhibit 16.2 is an overview of appropriations and expenditures by activity.

Specific Initiatives

16.18 The balance of this chapter gives an account of four areas where the Office is focusing particular attention: auditing the Public Accounts; program evaluation and internal audit; the work of the Crown Corporations group; and the field of computerization.

Auditing the Public Accounts

16.19 There has been much discussion in recent years of the Office's initiatives in the area of value-for-money auditing. Previous annual Reports describe in detail the Office's progress in making the value-for-money segment of our audits more cost-effective. These initiatives continue.

16.20 For example, the Office has been trying to balance its emphasis on systems and processes with audits oriented more toward programs and operations. At present, a special Professional Practices group project is to review the cost-effectiveness of our comprehensive audits, examining the state of the art in this field in Canada and other countries in both government and the private sector. The project will also build on the knowledge and experience of Office audit teams that have completed or are engaged in these types of audit.

16.21 However, this emphasis on value-for-money auditing tends to obscure the reality that a very large portion of the Office's work is in the more traditional categories of legislative audit. The Auditor General Act, section 6, requires that the Auditor General

> shall examine the several financial statements required by section 55 of the Financial Administration Act to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have.

16.22 This requirement involves the Office in extensive financial or attest auditing in all government departments and agencies each year, and results in the Opinion and Observations by the Auditor General on the Financial Statements of the Government of Canada, which appear in the Public Accounts. This is in addition to the financial auditing that takes place in each of the Crown-owned corporations where the Auditor General is auditor.

Exhibit 16.2

OFFICE OF THE AUDITOR GENERAL OF CANADA
APPROPRIATIONS AND EXPENDITURES

Appropriations and Expenditures by Actitivy

(thousands of dollars)

	1986-87	1985-86		1984-85	
	Estimates	Appropriations	Expenditures	Appropriations	Expenditures
Legislative Auditing	44,543	43,390	42,433	41,126	39,727
TOTAL	44,543	43,390	42,433	41,126	39,727

Appropriations and Expenditures by Object

(thousands of dollars)

	1986-87	1985-86		1984-85	
	Estimates	Appropriations	Expenditures	Appropriations	Expenditures
Salaries and Wages	28,652	27,753	26,381	26,575	24,169
Contributions to Employee Benefit Plans	3,949	4,212	4,212	3,883	3,883
Transportation and Communications	2,918	2,525	2,956	2,600	2,441
Information	273	106	299	110	99
Professional and Special Services	6,960	7,112	6,185	6,527	6,629
Rentals	262	238	284	246	280
Purchased Repair and Upkeep	296	103	223	105	202
Utilities, Materials and Supplies	350	471	429	485	601
Capital-Construction or Acquisition of Machinery and Equipment	438	450	1,042	220	1,060
Transfer Payments	435	410	410	364	358
All Other Expenditures	10	10	12	11	5
TOTAL	44,543	43,390	42,433	41,126	39,727

16.23 Part of section 7 of the Auditor General Act requires the Auditor General to bring to the attention of the House of Commons any cases in which he has observed that

- accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;
- essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized; and
- money has been expended other than for purposes for which it was appropriated by Parliament.

16.24 These requirements spell out the vital obligation of the parliamentary auditor to identify and report to Members of Parliament cases observed where legislative authorities have not been complied with and where public money has not been spent for the purposes voted by Parliament. The requirements extend the attest function to encompass what the Office refers to as "authorities auditing". Our auditors identify occasions where, for example, irregular payments have been made, power to expend funds has been exceeded, payments have been made in advance of need, authorities have not been complied with, and other similar matters. Where these are deemed to be of significance and of a nature that they should be brought to the attention of the House of Commons, they are included in the annual Report.

16.25 Over the past two years, the Office of the Auditor General has been making a sustained and determined effort to find more cost-effective ways of performing these financial and authorities audits.

16.26 Three factors have contributed to the current intensity of this effort. The first is the growth of computerization; electronic data processing is now widely used in auditing, partly in response to the fact that the "books" to be audited are increasingly being produced using electronic media. The second is that the auditing profession has been examining the question of how much audit work is needed to enable the auditor to provide an opinion. The third is that the Office of the Auditor General, as already noted, has been revising its Comprehensive Auditing Manual, as part of its continual update of its methodology and practices. The revised manual requires the most up-to-date and cost-effective audit techniques.

16.27 In essence, the methodology we have developed involves separating the audit work required by section 6 of the Auditor General Act from that required by section 7. The determination is then made as to how much audit assurance each audit procedure provides, and only what is required to provide sufficient audit assurance to give an opinion on the government's financial statements is selected and performed. This methodology also calls for increased use of statistical sampling, employing the Office's newly developed computerized Central Data Selection procedures and IDEA software, described later in this chapter. As part of the revision process, materiality and the extent of overall audit assurance required were critically evaluated and adjusted where necessary.

Examining gold bars at the Royal Mint is part of the OAG's traditional audit function.

Discussion of the Special Examination in the Northern Canada Power Commission takes place in the OAG's Vancouver regional office.

Planning the Public Accounts audit.

16.28 The whole thrust of the new process is to allow the Auditor General to provide his opinion on the financial statements on the basis of the appropriate amount of auditing. Too much would be wasteful; too little would be unacceptable professionally. The benefit is more cost-effective use of the Office's resources.

Program Evaluation and Internal Audit

16.29 The Government's Task Force on Program Review (the Nielsen Task Force) wrote of the Office of the Auditor General that:

> ... the Minutes of Proceedings and Evidence of the Standing Committee on Public Accounts ... provide continuous evidence of the generally high degree of satisfaction on the part of the Committee with the work of the Office of the Auditor General. But laudatory comments on individual audits, or on cross-cutting analyses which form major themes of particular reports by the Auditor General, are not the same thing as an evaluation of the totality of work taken on by his or her Office. Indeed, a judgement that any single area of the Auditor General's work is being well done could be quite consistent with a view that, in the aggregate, too much was being done - or being too well done...

16.30 The report described the Office's Program Evaluation and Internal Audit group and its objectives as follows:

- assessing the effectiveness with which the Office's audit activities support the scrutiny role of the House of Commons;

- assessing whether the quality of the Office's audit work is such that it selects matters of most significance for review, and that it reviews these in a professional and cost-effective manner; and

- assessing whether important management practices and procedures throughout the Office reflect due regard for value for money.

16.31 It went on to comment that the second of these objectives was particularly relevant to the question "how much auditing is enough?" and that it was "therefore encouraging that the Auditor General intends to inform the House of Commons, probably through his annual Report, of major findings in these three areas".

16.32 The following is a summary of the work carried out by the Program Evaluation and Internal Audit group during the past year.

16.33 **Evaluation of professional development.** In 1985-86, the Auditor General commissioned a private consulting firm to evaluate the Office's professional development training program. The scope of the study was limited to the professional development courses for auditors, excluding the student training program leading to professional certification and training for the International Fellows on short-term appointments to the Office.

16.34 The consultants conducted a written survey and interviews with a sample of one in five professional staff at the OAG to investigate the on-the-job usefulness of skills and knowledge acquired in training. The consultants also observed a number of OAG professional development courses and visited four other auditor training organizations in the United States and Great Britain.

16.35 The main findings of the study were that professional development courses played an important part in developing auditor capabilities; that the OAG had made a sustained and substantial effort to make ongoing training opportunities available to staff; that new audit techniques were disseminated to the staff through training courses; and that most auditors believed the courses provided good value for money in terms of usefulness on the job. The study also found that the OAG's training program compared favourably with that of the other national office of a similar size visited by the consultants. The other three audit offices reviewed were either too much larger or too much smaller than the OAG to allow direct comparisons. However, the consultant's review of the audit training programs in these three offices identified specific examples of excellent training practices that the OAG might consider adopting.

16.36 As comprehensive auditing continues to evolve it will present an increasing challenge to the "training needs analysis and course design" processes within the OAG. Extensive analysis will have to be made of the specific audit tasks to be carried out by the course target groups of the related skills and knowledge to be taught.

16.37 Other related recommendations included:

- giving highest priority to continually updating training in value-for-money auditing, audit project management and data analysis skills;
- providing longer and more intensive in-house training for high priority subjects; and
- implementing, on an urgent basis, the current plan to develop curricula for group and developmental levels in the OAG.

16.38 The importance of training to the OAG dictates that every opportunity should be taken to maintain it at the highest level of quality.

16.39 **Post-audit quality review.** A post-audit quality review (PAQR) is carried out annually on a representative portion of Office audit work.

16.40 *Departmental comprehensive audits.* In the past year, the PAQR work on departmental comprehensive audits pursued two questions, 1) Did the Office audit the right things? and 2) Did the Office audit things right?

16.41 As to the first, deciding what to audit in a departmental program is the most important decision in value-for-money auditing. It reflects not only the Office's interpretation of its mandate under the Auditor General Act but also what it considers important about the program being audited.

16.42 Over the past two or three years, the Office has reoriented its approach to value-for-money audits. Less emphasis is being placed on auditing administrative support systems and more on the management and control activities of program delivery.

16.43 Experimentation in audit approaches has been encouraged, and it has been left to individual audit Principals to interpret exactly what is meant by a program-oriented audit and by program results. This led to something of a dilemma: too diligent a pursuit of program results might risk overstepping the Office mandate, but an overly cautious one would lead to auditing matters of little significance. Some of the audit work examined by PAQR fell into these two categories, with the remainder in the middle – but comfortably, perhaps too comfortably, away from the limits of the Office mandate.

16.44 PAQR has recommended, for field testing, an approach to deciding on audit scope that should lead to greater consistency in selecting matters of significance for audit. Further, it has recommended that the Office's Professional Practices group undertake development of explicit criteria and methodology for this approach.

16.45 The second question addressed by PAQR, whether the Office audited things right, called for an assessment of the appropriateness of the audit objectives, as well as the tasks and procedures followed in achieving them.

16.46 PAQR found that the diversity of government programs required equally diverse audit approaches and techniques. The OAG Comprehensive Auditing Manual can provide only general guidance in the development of audit programs. Audit Principals are expected to, and do, exercise considerable flexibility in their approach to the audit of particular programs. While innovation is expected and encouraged, it must fall within the boundaries of generally accepted auditing standards.

16.47 Once audit Principals have selected matters of significance for audit in any particular departmental program, they must carry out the audit in a professional and cost-effective manner. A well designed and executed audit program will accomplish this.

16.48 PAQR examined a cross-section of departmental audit work reported on in the 1985 annual Report. Particular attention was paid to assessing the design and use of audit programs.

16.49 Here again, the transition to program auditing has had its effect. Audit programs tended to be more exploratory and less crisp than was the case in auditing administrative support systems.

16.50 PAQR concluded that the audit work met generally accepted standards but that there were some opportunities for increasing productivity. A number of recommendations were prepared for the consideration of the Executive Committee.

16.51 *Crown corporations and other entities.* The review of audit reports on these organizations was preceded by development, for field testing, of a standardized PAQR assessment method which would permit comparisons of quality across audits and over time. The merits and practicability of this approach will be determined over the next several months. Meanwhile, the PAQR reviews conducted so far reveal continued compliance with generally accepted auditing standards. As well, the audit aids introduced in the preceding year were satisfactorily implemented.

16.52 Follow-up on the previous year's PAQR work showed that subsequent audits satisfactorily implemented the PAQR recommendations.

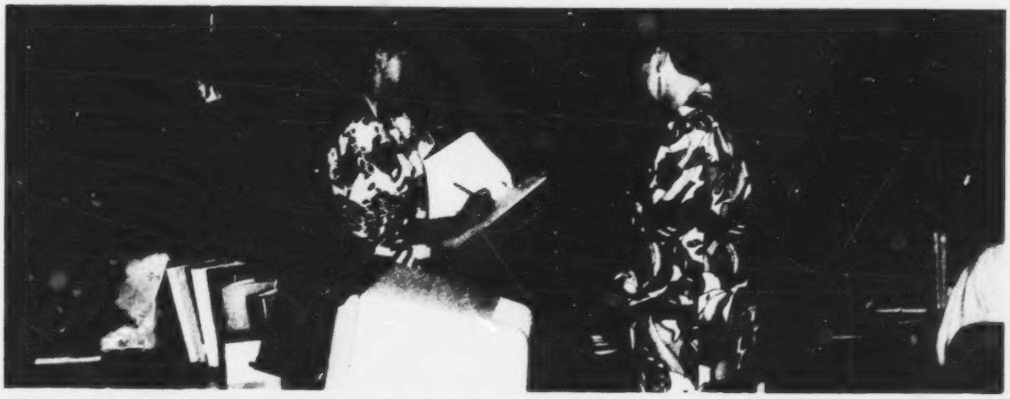
16.53 *Accounts of Canada.* The PAQR examination of the Office's work in this area has so far disclosed satisfactory compliance with generally accepted auditing standards.

16.54 **Internal Audit of Administrative Services Branch.** The objective of this audit was to assess the reasonableness of the nature, level and costs of services provided by the Administrative Services Branch.

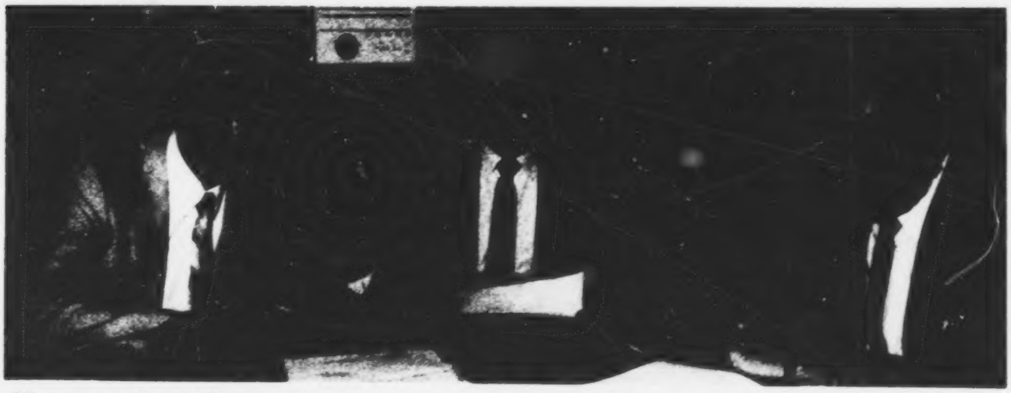
16.55 The Branch's services include personnel, corporate EDP systems, finance, contracting, official languages, materiel, accommodation, records and mail, word processing and audio-visual services – much like the administrative functions of most government departments. The cost of these services for 1986-87 is budgeted at 122 person-years (18.5 per cent of the total person-years for the Office) and $7 million (16 per cent of the Office's budget).

16.56 The audit examined how the need for the various administrative services is established, delivered and controlled. Comparisons were made with other legislative auditing bodies and public accounting firms with allowances for differences in size and environment. Users were interviewed and surveyed to determine their satisfaction with the services and to elicit any suggestions or comments about how they could or should be improved.

16.57 The internal audit is not finished, and the observations are not complete. It appears, however, that the services provided by the Branch are generally consistent with administrative services provided by the other organizations contacted, and staff are generally satisfied with the types and levels of service provided. It also appears that the costs of providing administrative services to the Office are roughly comparable to costs in other legislative audit organizations.



The internal audit of the Office's administration function looks at the OAG's Word and Information Systems.



Members of the Office's internal audit and program evaluation group discuss their findings.

16.58 The Branch has made progress in developing and documenting administrative policies and procedures for the Office and in formalizing its own management planning and control systems.

16.59 For Personnel and Corporate EDP Services within the Branch, the audit has been completed, and some important opportunities for improvement have been identified.

16.60 The Personnel group and the Office as a whole would benefit from more comprehensive development and dissemination of personnel policies. The Personnel group also needs to become more formally involved in the Office's overall planning for human resources through participation in both strategic and operational planning activities. This would facilitate the shift from a reactive to a more active approach by the group on a short- and long-term basis. Also, the Personnel group should tighten its controls over classification actions, particularly monitoring of non-audit positions to ensure that position descriptions properly reflect the duties performed.

16.61 While positions occupied by non-audit staff are classified according to classification standards, for its audit professionals the Office has adopted a practice of appointment to level of competence. In both cases, appropriate monitoring of promotions and classification actions is critical to provide adequate control over the inevitable pressure for higher classifications and pay and to ensure that classification levels of staff match actual work requirements.

16.62 Generally, the EDP Services unit provides efficient and effective services. The audit did, however, reveal that some Office staff were not aware of the range of services provided by the unit and consequently less than full use is made of its outputs.

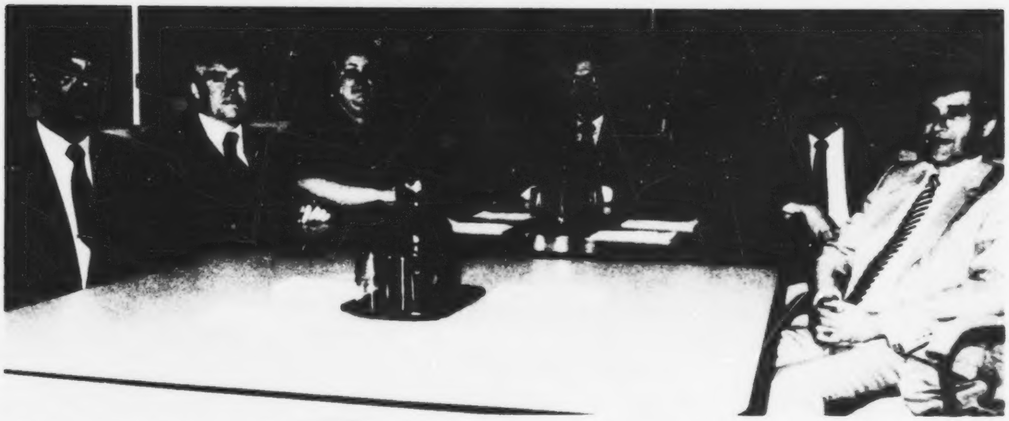
16.63 The overall management of EDP in the Office is also of some concern. EDP development activity under the direction of the Audit Operations Branch's Computer Audit group is now focused on facilities and applications to increase the efficiency of audit teams. The increased activity of the Computer Audit group, particularly in identifying needs for administrative and managerial systems, has led to some confusion concerning responsibility for the Office's overall long-term EDP strategy.

16.64 The internal audit is continuing, and the remaining areas will be reported on in our next annual Report.

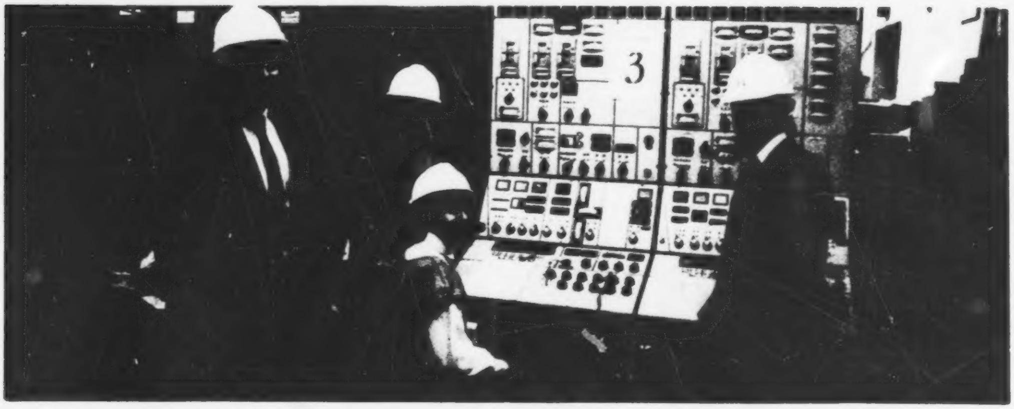
Work of the Crown Corporations Group

16.65 When the amendments to the Financial Administration Act affecting control and accountability of Crown corporations came into force in 1984, the Office took on a whole new area of responsibility. In addition to providing opinions on the financial statements and on compliance with authorities in those Crown corporations where he is the appointed auditor, the Auditor General now has the following responsibilities:

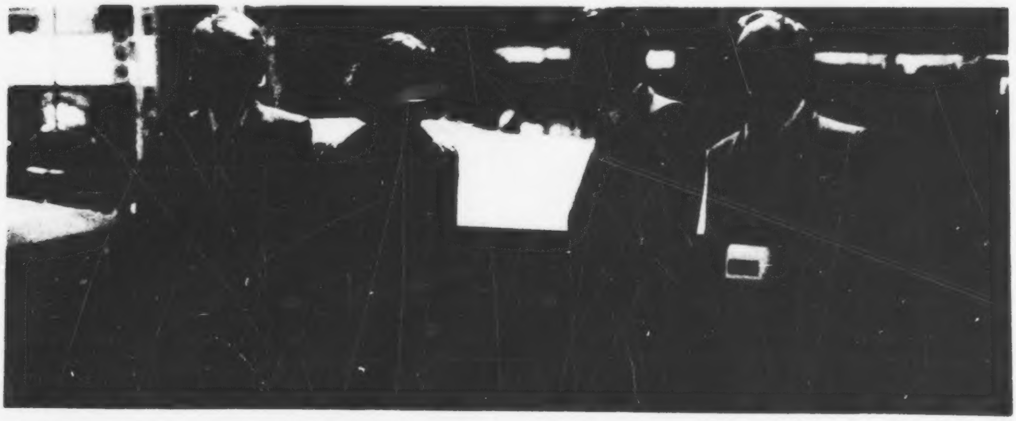
- to report, when required to do so in those corporations where he is the auditor, on the accuracy and consistency of quantitative performance information contained in Crown corporations' annual reports;
- at least once every five years, to conduct a special examination (a review of financial and management control and information systems and management practices) in some 30 Crown corporations;
- to be consulted by other auditors carrying out audits and special examinations of Crown corporations with respect to any matter that, in the opinion of those auditors, should be brought to the attention of Parliament; and
- to attest to the accuracy of quarterly reports, submitted by Treasury Board to Parliament, concerning the timely tabling of annual reports and summaries of corporate plans and budgets.



Members of the Crown Corporations group in a planning meeting.



A Crown Corporations team audits Atomic Energy of Canada Limited.



Another team is responsible for auditing Canada Post Corporation.

16.66 Further, on and after 1 January 1989, the Auditor General will become the sole or joint auditor of each parent Crown corporation named in Part I of Schedule C of the Financial Administration Act. This will result in an additional five corporations being audited by the Office. The corporations named in Part I are those that are ordinarily dependent on appropriations for operating purposes or that do not operate in a competitive environment.

16.67 To provide a focal point for fulfilling its responsibilities with respect to Crown corporation audits, the Office has formed a Crown Corporations group within the Audit Operations Branch. This group has both functional and operational responsibilities.

16.68 **The Accountability Issues unit** assists in developing Office policy concerning the accountability of Crown corporations and other non-departmental entities in which the government has an interest. With respect to the amended Financial Administration Act, the unit provides advice and assistance to audit teams conducting special examinations and, when required, audits of quantitative information. The unit also provides advice to private sector auditing firms involved in Crown Corporation audits and special examinations.

16.69 **The Technical Resources unit** is responsible for ensuring the quality of audit opinions and financial reports issued by the Office. Its activities cover mainly Crown corporations but extend to all other entities for which the Auditor General issues a separate audit opinion, except for the Accounts of Canada.

16.70 The unit's main objective is to develop and ensure the implementation of Office policy, standards and methodology in presenting opinions, financial reports and statements. It offers a consultation service to audit teams to help them resolve technical accounting, financial statement presentation and audit reporting problems and to keep up with current professional developments. It must review all draft financial statements and audit opinions before the Auditor General or the designated Deputy Auditor General signs the auditor's report. This activity involves reviewing approximately 100 separate audit opinions each year.

16.71 **Current operational activities** of the Crown Corporations group arise from its responsibility for the annual financial (attest) audit work in three major Crown corporations: Atomic Energy of Canada Limited (AECL); the Canadian Broadcasting Corporation (CBC); and Canada Post Corporation (CPC). In addition, the group is responsible for special examinations of CPC and AECL.

16.72 These audit activities are the specific responsibility of the Crown Corporations group; but this by no means describes the total work of the Office in auditing Crown corporations. A far larger number of audits (see paragraphs 16.89 to 16.96) is carried out by Departments and Agencies Audit groups whose areas of concern encompass related Crown corporations and other entities.

Work of the Computer Audit Group

16.73 Over the past few years, the Office of the Auditor General has moved rapidly and definitively into the information systems era. This has meant that office automation is a way of life for virtually all staff. It is used in the Office for everything from the time reporting system that requires all personnel – from the Auditor General down – to complete a weekly time report accounting for their time to the nearest one-tenth of an hour, to the word and graphics processing capability that produces the camera-ready copy of this Report. This application of technology for administrative and production purposes has proved highly successful and cost-effective.

16.74 The audit applications of this technology have been even more significant for the Office. Audit applications of electronic data processing are the overall responsibility of the Office's Computer Audit group. The group provides expertise and methodology to audit teams evaluating financial controls in computerized systems in departments and agencies and for assessing whether value for money has been achieved in expenditures on electronic data processing. The group has five main activities:

- providing EDP audit expertise to support the Office's financial audit work; for example, the attest opinion given by the Office on the government's financial statements and those of some Crown corporations, and the assessment of the adequacy of financial controls in EDP-based systems in the government;

- providing facilities and expertise to the Office in the areas of sampling methodology and computer audit software;

- providing staff to audit the value-for-money component of EDP management and control in comprehensive audits and government-wide studies;

- identifying and carrying out investigations of EDP issues across government; and

- providing overall support to microcomputer users in the Office.

16.75 The group is involved in a continuing analysis of where computers can improve the efficiency of the Office's audit work, recognizing that specific audit approaches must be developed for government departments, agencies and Crown corporations that are now highly computerized. These approaches include planning, internal control evaluations of computerized applications, and substantive testing using computer software to access client files.

16.76 As reported last year, the IDEA concept was one important product of the group's analysis of computer needs – Interactive Data Extraction and Analysis. This software was developed in the Office of the Auditor General. It provides a method for allowing an auditor to bring an audit client's data onto a microcomputer. It is interactive, flexible and very easy to use. The auditor can run any number of enquiries without incurring additional computer processing cost. Because the system responds within seconds to each enquiry, the auditor can explore financial records at great speed and in greater depth than was previously possible.

The work of the Computer Audit group now affects all the OAG's auditing activities.

16.77 A part of the activity of the Computer Audit group during the past 12 months has been in implementing applications of IDEA for specific audit situations. At the same time, paralleling IDEA, has been the development within the Office of the Central Data Selection (CDS) system. The entire data bank of the Consolidated Revenue Fund is analysed and balanced on large mainframe computers and can then be made available by entity for the Office's departmental auditors to use with IDEA.

16.78 CDS is a set of data extraction mainframe programs designed to access in detail the general ledger of the Government of Canada's Central Accounting System. The general ledger files contain the detailed records used in preparing the monthly departmental statements and the government's financial statements. The CDS system can produce reports on departments, accounts, standard objects or cost centres, based on techniques such as statistical sampling, selection of high value items, variance analysis and journal voucher analysis.

16.79 The use of microcomputer technology has resulted in many significant productivity improvements and greater efficiency in our audit work.

16.80 IDEA was introduced to audit teams in November 1985, five months before the close of 1985-86 fiscal year. In those five months, IDEA was used on some 55 audit engagements by Office staff. At the time of this Report going to press, 22 audit teams were using the system. The increase in audit productivity and effectiveness has been marked. For example:

- IDEA was used in the audit of the Canada Deposit Insurance Corporation. Within two days of receiving the relevant computer tapes from the Corporation, our auditors had loaded the data onto IDEA and were taking samples and looking into the payouts. This work would in the past have taken a computer specialist some three weeks to perform.
- The system was employed in the audit of a federal Crown corporation. Here the Office recreated the revenue side of the Corporation's financial statements using IDEA. We found some significant differences. These were eventually traced to an error during a conversion to a new computerized accounting system by the Corporation. The financial statements were duly adjusted, revenue and accounts receivable being reduced by $300,000.
- In the audit of Energy, Mines and Resources, by using IDEA instead of our normal mainframe data extraction, we saved some $10,000 in direct computer processing time, compared to the previous year.

16.81 For several audit teams the use of micro-based spreadsheet programs has also resulted in productivity gains in simple yet effective ways. For example, in the Federal Government Reporting Study (FGRS) many complex spreadsheets were developed to model and restate past governmental financial data using proposed new accounting rules. This saved a tremendous amount of manual effort and reduced potential errors.

16.82 An auditor on the Department of Energy, Mines and Resources team used a spreadsheet to develop a salary model for EMR, estimating salary costs for the fiscal year as part of the annual Public Accounts audit. Using the spreadsheet model, the audit team can detect material errors in EMR's pay costs within two days, in place of the two weeks it used to take using traditional pencil and calculator procedures.

16.83 For the Canadian Dairy Commission audit, the auditors used a spreadsheet application to program subsidy payment calculations. Using their spreadsheet to reprocess the Commission's subsidy payments, the auditors reported a time saving of 100 hours from the 150 it used to take to do this audit step alone. The audit director reported that the microcomputer not only improved the accuracy of calculations but also relieved the auditor of the tedious task of performing some 3,000 individual calculations by hand.

16.84 The combination of IDEA, Central Data Selection and other microcomputer technology is enabling the Office to become much more efficient and effective in its audit work. Overall, during the last five months of 1985-86, IDEA and other microcomputer applications reduced our direct service costs by at least $40,000. In addition, IDEA has received considerable attention from other government departments, audit firms, and audit offices around the world.

16.85 The Office of the Comptroller General is already using IDEA and has come to an agreement with the Department of Supply and Services to support other government departments and agencies that wish to use the system. The Department of Energy, Mines and Resources is currently using the system as a very effective financial analysis tool. It has found that IDEA saves both time and money. National Revenue-Taxation is testing it for use on taxpayer audits, and the Canadian Broadcasting Corporation has installed it for use by its internal audit group.

16.86 The Office has received enquiries from many other departments, agencies and Crown corporations and has made IDEA available to departments and other government entities at no cost.

16.87 The Canadian Institute of Chartered Accountants (CICA) has entered into an agreement with the Government of Canada to market the IDEA system worldwide to auditors and financial managers. The results of these negotiations are that, based on the CICA's marketing plan, the Government of Canada stands to recover almost all the initial development costs of IDEA over the next five years. Furthermore, the Office will receive, free of charge, significant continuing enhancements to the software that are to be paid for by the CICA. These enhancements will also be available to other government departments at nominal cost.

16.88 Last year our annual Report said that "the development of IDEA is a major achievement by the Office and a significant breakthrough in computer auditing. It is expected to have an enormous impact on audits throughout the Office and, indeed, throughout the auditing community." In light of the widespread acceptance of IDEA and of the development of further techniques by the Computer Audit group, that "enormous impact" can be seen already to be taking place.

Costs Incurred in Preparing Reports of Audits and Special Examinations in Crown Corporations

16.89 Section 149(2) of part XII of the Financial Administration Act (FAA) requires that where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred in preparing any report under sections 139 and 143 shall be disclosed in his next annual Report and be paid out of the moneys appropriated for his Office.

16.90 The costs reported here pursuant to section 149(2) represent the full costs incurred by the Office in carrying out the audit and special examination work and preparing particular reports under section 139 or 143 of the FAA. These costs are reported here only when the work has been completed.

16.91 The total costs of Crown corporations work include costs incurred on work not specifically required under section 139 or 143. This includes, for example, work in relation to issuing prospectuses, advising on information and internal control systems, and helping to resolve accounting issues and to prepare financial statements. The costs incurred for this work are not reported in this chapter.

Annual Audit Reports

16.92 Under section 139 of the FAA, each parent Crown corporation is required to have an annual auditor's report prepared, in respect of itself and its wholly-owned subsidiaries, on the financial statements and on any quantitative information that the Treasury Board requires to be audited. Also, the auditor must prepare such other reports as the Governor in Council may require.

16.93 Exhibit 16.3 shows the costs incurred in performing the completed audits and preparing the annual auditor's reports required by section 139 for those corporations and subsidiaries audited solely or jointly by the Auditor General of Canada. The costs refer to the completed annual audits for fiscal years ending on or before 31 March 1986.

16.94 The costs reported do not include any costs for the audit of quantitative performance information, because no such audits have been requested by the Treasury Board for any of the corporations the Office audited. Similarly, there were no other reports required by the Governor in Council under section 139.

Special Examination Reports

16.95 Under section 143 of the FAA, on completion of a special examination, the examiner is required to submit a report of the findings to the board of directors of the corporation examined. The examiner of any corporation listed in Schedule C-1, of the FAA may also make special reports to the appropriate minister or to Parliament where, in the examiner's opinion there is information that should be brought to the attention of either.

16.96 Although work on special examinations has started in some corporations, the Office's costs will not be reported until reports have been issued to the boards of directors.

Exhibit 16.3

COSTS OF PREPARING ANNUAL AUDIT REPORTS FOR FISCAL YEARS ENDING ON OR BEFORE 31 MARCH 1986

Crown Corporation	Fiscal Year Ended	Cost Incurrred
Atlantic Pilotage Authority	31.12.85	$ 44,700
Atomic Energy of Canada Limited	31.03.86	407,000
Canada Deposit Insurance Corporation	31.12.85	470,700
Canada Development Investment Corporation (Joint Auditor)	31.12.85	48,700
Canadair Financial Corporation Inc.	31.12.85	11,500
Canada Harbour Place Corporation	31.03.86	55,000
Canada Lands Company Limited	31.03.86	6,200
Canada Lands Company (Le Vieux-Port de Montréal) Limited	31.03.86	43,800
Canada Lands Company (Mirabel) Limited	31.03.86	119,400
Canada Lands Company (Vieux-Port de Québec) Inc.	31.03.86	137,300
Canada Museums Construction Corporation Inc.	31.03.86	65,000
Canada Post Corporation (Joint Auditor)	31.03.86	224,700
Canadian Arsenals Limited	31.03.86	210,900
Canadian Commercial Corporation	31.03.86	153,700
Canadian Dairy Commission	31.07.85	190,200
Canadian Livestock Feed Board	31.03.86	44,400
Canadian National (West Indies) Steamships Limited	31.12.85	4,600
Canadian Patents and Development Limited	31.03.86	27,300
Canadian Saltfish Corporation	31.03.86	110,100
Canagrex	31.03.86	10,100
Defence Construction (1951) Limited	31.03.86	62,400
Export Development Corporation	31.12.85	341,700
Farm Credit Corporation	31.03.86	211,300
Freshwater Fish Marketing Corporation	30.04.85	114,100
Great Lakes Pilotage Authority, Ltd.	31.12.85	42,800
International Centre for Ocean Development	31.03.86	18,100
Laurentian Pilotage Authority	31.12.85	59,400
National Capital Commission	31.03.86	213,400
Northern Canada Power Commission	31.03.86	144,700
Pacific Pilotage Authority	31.12.85	56,900
Royal Canadian Mint	31.12.85	314,000
The St. Lawrence Seaway Authority	31.03.86	125,000
Seaway International Bridge Corporation Ltd	31.12.85	25,800
The Jacques Cartier and Champlain Bridges Incorporated	31.03.86	42,300
Standards Council of Canada	31.03.86	43,200
Teleglobe Canada	31.03.86	244,900
Uranium Canada Limited	31.12.85	1,700
Vancouver Port Corporation	31.12.85	90,300

Advisers to the Auditor General

Membership of the Panel of Senior Advisers

Kenneth G. Belbeck, F.M.C.
Thorne Stevenson & Kellogg

H. Marcel Caron, F.C.A.
Clarkson Gordon

Gordon H. Cowperthwaite, F.C.A.
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Frank A. Hughes, C.A.
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Membership of the Independent Advisory Committee to the Auditor General on Government Accounting and Auditing Standards

Kenneth M. Dye, F.C.A. (Chairman)
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Henry E. McCandless, C.A. (Secretary)
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Leonard Rutman, Ph.D.
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W.R. Sloan, F.C.A.
Arthur Andersen & Co.

APPENDIX A

AUDITOR GENERAL ACT

25-26 ELIZABETH II

CHAPTER 34

An Act respecting the office of the Auditor
General of Canada and matters related
or incidental thereto

[*Assented to 14th July, 1977*]

Her Majesty, by and with the advice and
consent of the Senate and House of Commons
of Canada, enacts as follows:

PART I

SHORT TITLE

Short title 1. This Part may be cited as the *Auditor General Act*.

INTERPRETATION

Definitions 2. In this Act,

"Auditor General" "Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);

"Crown corporation" "Crown corporation" has the meaning assigned by section 95 of the *Financial Administration Act*; s.c. 1984, c. 31, s. 14

"Department" "Department" has the meaning assigned to that term by section 2 of the *Financial Administration Act;*

"Registrar" "Registrar" means the Bank of Canada and a registrar appointed under Part IV of the *Financial Administration Act*.

AUDITOR GENERAL OF CANADA

Appointment and tenure of office 3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem (2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.

Re-appointment (3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.

Vacancy

(4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General.

Salary

4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.

- S.C. 1976-77, c. 34, s. 4(1);
- S.C. 1980-81-82-83, c. 50, s. 23;
- S.C. 1980-81-82-83, c. 55, s. 1.

Pension benefits

(2) The provisions of the *Public Service Superannuation Act*, other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the *Diplomatic Service (Special) Superannuation Act* in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the *Public Service Superannuation Act* do not apply to him.

DUTIES

Examination

5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act.

Idem

6. The Auditor General shall examine the several financial statements required by section 55 of the *Financial Administration Act* to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have.

- S.C. 1976-77, c. 34, s. 6;
- S.C. 1980-81-82-83, c. 170, s. 25.

Report to House of Commons

7. (1) The Auditor General shall report annually to the House of Commons

(a) on the work of his office; and,

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

Idem

(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency; or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

Submission of report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before the 31st day of December in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receipt thereof by him or, if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

Special report

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in his opinion, should not be deferred until the presentation of his annual report.

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 20(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

Idem

9. The Auditor General shall

(a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and;

(b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act;*

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities.

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board.

Inquiry and Report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board.

ACCESS TO INFORMATION

Access to information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*.

Reliance on audit reports of Crown corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of

the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada.

STAFF OF THE AUDITOR GENERAL

Officers, etc.

15. (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act*.

Contract for professional services

(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in *Appropriation Acts*, contract for professional services.

Delegation to Auditor General

(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under sections 21 and 31 of that Act and inquiries under section 32 of that Act.

Suspension

(4) The Auditor General may suspend from the performance of his duty any person employed in his office.

Responsibility for personnel management

16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph 5(1)(*e*) and section 7 of that Act.

Collective agreements

17. Any collective agreement affecting persons employed in the office of the Auditor General entered into before the coming into force of this Act remains in force and binds the Auditor General as employer of such persons until the expiry of that agreement.

Classification standards

18. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office.

Delegation

19. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 55 of the *Financial Administration Act* and his reports to the House of Commons under this Act and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General.

ESTIMATES

Estimates

20. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office.

Approbation allotments

21. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General.

AUDIT OF THE OFFICE OF THE AUDITOR GENERAL

Audit of office of the Auditor General

22. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting.

PART II

CONSEQUENTIAL AND RELATED AMENDMENTS

R.S., c. F-10

23. Part VII of the *Financial Administration Act* is repealed.

R.S., c. P-35

24. (1) Part I of Schedule I to the *Public Service Staff Relations Act* is amended by deleting therefrom the words "Office of the Auditor General of Canada".

(2) Part II of Schedule I to the *Public Service Staff Relations Act* is amended by adding thereto the words "Office of the Auditor General of Canada".

R.S., c. E-8

25. Section 16 of the *Established Programs (Interim Arrangements) Act* is repealed and the following substituted therefor:

Powers of Auditor General

"**16.** Nothing in this Act shall be construed to restrict the powers of the Auditor General of Canada under the *Auditor General Act*."

1970-71-72, c. 52

26. Section 27 of the French version of the *Pilotage Act* is repealed and the following substituted therefor:

Vérificateur général

"27. Le vérificateur général vérifie chaque année la comptabilité et les opérations financières de chaque Administration et en fait rapport au Ministre."

R.S., c. N-22

27. Subsection 23(5) of the *Northwest Territories Act* is repealed and the following substituted therefor:

Powers of Auditor General

"(5) The Auditor General has, in connection with his examination of the accounts of the Territories, all the powers that he has under the *Auditor General Act* in connection with the examination of the accounts of Canada."

R.S., c. Y-2

28. Subsection 26(5) of the *Yukon Act* is repealed and the following substituted therefor:

Powers of Auditor General

"(5) The Auditor General has, in connection with his examination of the accounts of the Territory, all the powers that he has under the *Auditor General Act* in connection with the examination of the accounts of Canada."

1970-71-72, c. 48

29. Section 15 of the French version of the *Unemployment Insurance Act*, 1971 is repealed and the following substituted therefor:

Vérification

"15. Le vérificateur général vérifie chaque année la comptabilité et les opérations financières de la Commission et en fait rapport au Ministre."

Amendments to French version

30. Whenever, in the French version, the expression "auditeur général" appears in any provision of an Act listed in the schedule to this Act, there shall in every case, unless the context otherwise requires, be substituted the expression "vérificateur général".

PART III

COMMENCEMENT

Coming into force

31. This Act shall come into force on a day to be fixed by proclamation.

APPENDIX B

FINANCIAL ADMINISTRATION ACT

EXTRACTS FROM PART XII

FINANCIAL ADMINISTRATION ACT

R.S., c. F-10 (amended)

Extracts from Part XII

CROWN CORPORATIONS

Financial Management

Books and systems

138. (1) Each parent Crown corporation shall cause

(a) books of account and records in relation thereto to be kept, and

(b) financial and management control and information systems and management practices to be maintained, in respect of itself and each of its wholly-owned subsidiaries, if any.

Idem

(2) The books, records, systems and practices referred to in subsection (1) shall be kept and maintained in such manner as will provide reasonable assurance that

(a) the assets of the corporation and each subsidiary are safeguarded and controlled;

(b) the transactions of the corporation and each subsidiary are in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(c) the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently and the operations of the corporation and each subsidiary are carried out effectively.

Internal audit

(3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly-owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the cost of such audits is not justified by the benefits to be derived therefrom.

Financial statements

(4) Each parent Crown corporation shall cause financial statements to be prepared annually, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with generally accepted accounting principles as supplemented or augmented by regulations made pursuant to subsection (6).

Form of financial statements

(5) The financial statements of a parent Crown corporation and of a wholly-owned subsidiary shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation or subsidiary.

Regulations

(6) The Treasury Board may, for the purposes of subsection (4), make regulations respecting financial statements either generally or in respect of any specified parent Crown corporation or any parent Crown corporation of a specified class, but such regulations shall, in respect of the preparation of financial statements, only supplement or augment generally accepted accounting principles. 1984, c. 31, s. 11.

Auditor's Reports

Annual auditor's report

139. (1) Each parent Crown corporation shall cause an annual auditor's report to be prepared, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with the regulations, on

(a) the financial statements referred to in section 138; and

(b) any quantitative information required to be audited pursuant to subsection (5).

Contents

(2) A report under subsection (1) shall be addressed to the appropriate Minister and shall

(a) include separate statements, whether in the auditor's opinion,

(i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year,

(ii) the quantitative information is accurate in all material respects and, if applicable, was prepared on a basis consistent with that of the preceding year, and

(iii) the transactions of the corporation and of each subsidiary that have come to his notice in the course of his examination for the report were in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(b) call attention to any other matter falling within the scope of his examination for the report that, in his opinion, should be brought to the attention of Parliament.

Regulations

(3) The Treasury Board may make regulations prescribing the form and manner in which the report referred to in subsection (1) is to be prepared.

Separate reports

(4) Notwithstanding any other provision of this Part, the auditor of a parent Crown corporation may prepare separate annual auditor's reports on the statements referred to in paragraph 139(1)*(a)* and on the information referred to in paragraph 139(1)*(b)* if, in his opinion, separate reports would be more appropriate.

Audit of quantitative information

(5) The Treasury Board may require that any quantitative information required to be included in a parent Crown corporation's annual report pursuant to subsection 152(3) be audited.

Other reports

(6) The auditor of a parent Crown corporation shall prepare such other reports respecting the corporation or any wholly-owned subsidiary of the corporation as the Governor in Council may require.

Examination

(7) An auditor shall make such examination as he considers necessary to enable him to prepare a report under subsection (1) or (6).

Reliance on internal audit

(8) An auditor shall, to the extent he considers practicable, rely on any internal audit of the corporation being audited that is conducted pursuant to subsection 138(3). 1984, c. 31, s. 11.

Errors and omissions

140. (1) A director or officer of a Crown corporation shall forthwith notify the auditor and the audit committee of the corporation, if any, of any error or omission of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on or in a report prepared by the auditor or a former auditor pursuant to section 139.

Idem

(2) Where an auditor or former auditor of a Crown corporation is notified or becomes aware of any error or omission in a financial statement that the auditor or former auditor has reported on or in a report prepared by the auditor or former auditor pursuant to section 139, he shall forthwith notify each director of the corporation of the error or omission if he is of the opinion that the error or omission is material.

Correction

(3) Where an auditor or former auditor of a Crown corporation notifies the directors of an error or omission in a financial statement or report pursuant to subsection (2), the corporation shall prepare a revised financial statement or the auditor or former auditor shall issue a correction to the report, as the case may be, and a copy thereof shall be given to the appropriate Minister. 1984, c. 31, s. 11.

Auditors

Appointment of auditor

141. (1) The auditor of a parent Crown corporation shall be appointed annually by the Governor in Council, after the appropriate Minister has consulted the board of directors of the corporation, and may be removed at any time by the Governor in Council, after the appropriate Minister has consulted the board.

Auditor General

(2) On and after January 1, 1989, the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each parent Crown corporation named in Part I of Schedule C, unless the Auditor General waives the requirement that he be so appointed.

Idem

(3) Subsections (1) and (2) do not apply in respect of any parent Crown corporation the auditor of which is specified by any other Act of Parliament to be the Auditor General of Canada, but the Auditor General is eligible to be appointed the auditor, or a joint auditor, of a parent Crown corporation pursuant to subsection (1) and subsections (8) to (10) do not apply to him.

Exception

(4) Notwithstanding subsection (1), where the report referred to in subsection 139(1) is to be prepared in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the auditor of the subsidiary, and subsections (6) and (8) to (11) and section 142 apply in respect of such auditor as though the references therein to a parent Crown corporation were references to the subsidiary.

Criteria for appointment

(5) The Governor in Council may make regulations prescribing the criteria to be applied in selecting an auditor for appointment pursuant to subsection (1) or (4).

Re-appointment

(6) An auditor of a parent Crown corporation is eligible for re-appointment on the expiration of his appointment.

Continuation in office

(7) Notwithstanding subsection (1), if an auditor of a parent Crown corporation is not appointed to take office on the expiration of the appointment of an incumbent auditor, the incumbent auditor continues in office until his successor is appointed.

Persons not eligible

(8) A person is disqualified from being appointed or re-appointed or continuing as an auditor of a parent Crown corporation if he is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or any of its affiliates.

Independence

(9) For the purpose of this section,

(a) independence is a question of fact; and

(b) a person is deemed not to be independent if he or any of his business partners

(i) is a business partner, director, officer or employee of the parent Crown corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates,

(ii) beneficially owns or controls, directly or indirectly through a trustee, legal representative, agent or other intermediary, a material interest in the shares or debt of the parent Crown corporation or any of its affiliates, or

(iii) has been a receiver, receiver-manager, liquidator or trustee in bankruptcy of the parent Crown corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.

Resignation

(10) An auditor of a parent Crown corporation who becomes disqualified under this section shall resign forthwith after becoming aware of his disqualification.

Qualifications preserved

(11) Nothing in this section shall be construed as empowering the appointment, re-appointment or continuation in office as an auditor of a parent Crown corporation of any person who does not meet any qualifications for such appointment, re-appointment or continuation established by any other Act of Parliament. 1984, c. 31, s. 11.

Resignation

142. A resignation of an auditor of a parent Crown corporation becomes effective at the time the corporation receives a written resignation from him or at the time specified in the resignation, whichever is later. 1984, c. 31, s. 11.

Special Examination

Special examination

143. (1) Each parent Crown corporation shall cause a special examination to be carried out, in respect of itself and its wholly-owned subsidiaries, if any, to determine if the systems and practices referred to in paragraph 138(1)*(b)* were, in the period under examination, maintained in a manner that provided reasonable assurance that *(a)* the assets of the corporation and each subsidiary were safeguarded and controlled; and

(b) the financial, human and physical resources of the corporation and each subsidiary were managed economically and efficiently and the operations of the corporation and each subsidiary were carried out effectively.

Time for examination

(2) A special examination shall be carried out at least once every five years and at such additional times as the Governor in Council, the appropriate Minister or the board of directors of the corporation to be examined may require.

Plan

(3) Before an examiner commences a special examination, he shall survey the systems and practices of the corporation to be examined and submit a plan for the examination, including a statement of the criteria to be applied in the examination, to the audit committee of the corporation, or if there is no audit committee, to the board of directors of the corporation.

Resolution of disagreements

(4) Any disagreement between the examiner and the audit committee or board of directors of a corporation over a plan referred to in subsection (3) may be resolved

(a) in the case of a parent Crown corporation, by the appropriate Minister; and

(b) in the case of a wholly-owned subsidiary, by the parent Crown corporation that wholly owns the subsidiary.

Reliance on internal audit

(5) An examiner shall, to the extent he considers practicable, rely on any internal audit of the corporation being examined conducted pursuant to subsection 138(3).

Report

(6) An examiner shall, on completion of the special examination, submit a report on his findings to the board of directors of the corporation examined.

Contents

(7) The report of an examiner under subsection (6) shall include

(a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection (3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and

(b) a statement of the extent to which the examiner relied on internal audits.

Special report to appropriate Minister

(8) Where the examiner of a parent Crown corporation named in Part I of Schedule C is of the opinion that his report under subsection (6) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the board of directors of the corporation, report that information to the Minister and furnish a copy of the report to the board.

Idem

(9) Where the examiner of a wholly-owned subsidiary of a parent Crown corporation named in Part I of Schedule C is of the opinion that his report under subsection (6) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the boards of directors of the subsidiary and

corporation, report that information to the Minister and furnish copies of the report to the boards.

Special report to Parliament (10) Where the examiner of a parent Crown corporation named in Part I of Schedule C is of the opinion that his report under subsection (6) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the board of directors of the corporation, prepare a report thereon for inclusion in the next annual report of the corporation and furnish copies of the report to the board, the appropriate Minister and the Auditor General of Canada.

Idem (11) Where the examiner of a wholly-owned subsidiary of a parent Crown corporation named in Part I of Schedule C is of the opinion that his report under subsection (6) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the boards of directors of the subsidiary and corporation, prepare a report thereon for inclusion in the next annual report of the corporation and furnish copies of the report to the boards, the appropriate Minister and the Auditor General of Canada. 1984, c. 31, s. 11.

Examiner **144.** (1) Subject to subsections (2) and (3), the auditor of a parent Crown corporation shall carry out a special examination.

Idem (2) Where, in the opinion of the Governor in Council, a person other than the auditor of a parent Crown corporation should carry out a special examination, he may, after the appropriate Minister has consulted the board of directors of the corporation, appoint an auditor who is qualified for the purpose to carry out the examination in lieu of the auditor of the corporation and may, after the appropriate Minister has consulted the board, remove that qualified auditor at any time.

Exception (3) Where a special examination is to be carried out in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the qualified auditor who is to carry out the special examination.

Applicable provisions (4) Subject to subsection (5), subsections 141(8) to (10) and section 142 apply in respect of an examiner as though the references therein to an auditor were references to an examiner.

Auditor General eligible (5) The Auditor General of Canada is eligible to be appointed an examiner and subsections 141(8) to (10) do not apply to him in respect of such an appointment. 1984, c. 31, s. 11.

Consultation with Auditor General

Consultation with Auditor General **145.** The auditor or examiner of a Crown corporation may at any time consult the Auditor General of Canada on any matter relating to his audit or special examination and shall consult the Auditor General with respect to any matter that, in the opinion of the auditor or examiner, should be brought to the attention of Parliament pursuant to paragraph 139(2)*(b)* or subsection 143(10) or (11). 1984, c. 31, s. 11.

Right to Information

Right to information

146. (1) On the demand of the auditor or examiner of a Crown corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such

(a) information and explanations, and

(b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.

Idem

(2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall

(a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the present or former directors, officers, employees or agents are reasonably able to furnish; and

(b) furnish the information and explanations so obtained to the auditor or examiner.

Reliance on reports

(3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

Policy

Restriction

147. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of

(a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;

(b) the objectives of the corporation; and

(c) any business or policy decision of the corporation or of the Government of Canada. 1984, c. 31, s. 11.

Qualified Privilege

Qualified privilege

148. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation has qualified privilege. 1984, c. 31, s. 11.

Costs

Cost of audit and examinations

149. (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 139 or 143 shall be reported to the President of the Treasury Board.

Idem

(2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 139 or 143 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

Audit Committee

Audit committee

150. (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

Idem

(2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

Duties

(3) The audit committee of a parent Crown corporation shall

(a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;

(b) oversee any internal audit of the corporation that is conducted pursuant to subsection 138(3);

(c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 139(1);

(d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in section 143; and

(e) perform such other functions as are assigned to it by the board of directors or the charter or by-laws of the corporation.

Auditor or examiner's attendance

(4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard thereat; and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting

(5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly-owned subsidiary

(6) Where the report referred to in subsection 139(1) is to be prepared in respect of a wholly-owned subsidiary separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though

(a) the references therein to a parent Crown corporation were references to the subsidiary; and

(b) the reference in paragraph (3)*(a)* to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

Reports

Accounts, etc. to Treasury Board or appropriate Minister

151. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on material developments

(2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on wholly-owned subsidiaries

(3) Each parent Crown corporation shall forthwith notify the appropriate Minister and the President of the Treasury Board of the name of any corporation that becomes or ceases to be a wholly-owned subsidiary of the corporation. 1984, c. 31, s. 11.

Annual report

152. (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.

Reference to committee

(2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the business and activities of the corporation submitting the report.

Form and contents

(3) The annual report of a parent Crown corporation shall include

(a) the financial statements of the corporation referred to in section 138;

(b) the annual auditor's report referred to in subsection 139(1);

(c) a statement on the extent to which the corporation has met its objectives for the financial year;

(d) such quantitative information respecting the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included therein; and

(e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included therein;

and shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly-owned subsidiaries, if any.

Idem

(4) In addition to any other requirements under this or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1984, c. 31, s. 11.

Annual consolidated report

153. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.

Reference to committee

(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.

Contents

(3) The annual consolidated report referred to in subsection (1) shall include

(a) a list naming, as of a specified date, all Crown corporations and all corporations of which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation;

(b) employment and financial data, including aggregate borrowings of parent Crown corporations; and

(c) such other information as the President of the Treasury Board may determine. 1984, c. 31, s. 11.

Quarterly report

153.1 (1) The President of the Treasury Board shall cause to be laid before each House of Parliament a copy of a report indicating, in respect of each quarter of each calendar year, the summaries and annual reports that under this Part were to be laid before that House in the quarter, the time at, before or within which they were to be laid and the time they were laid.

Attest

(2) The accuracy of the information contained in each quarterly report shall be attested by the Auditor General of Canada in his annual report to Parliament.

Time for tabling quarterly report

(3) A quarterly report shall be laid before each House of Parliament pursuant to subsection (1) on any of the first thirty days on which that House is sitting after the end of the quarter to which the report relates. 1984, c. 31, s. 11.

APPENDIX C

REPORTS TO THE STANDING COMMITTEE ON PUBLIC ACCOUNTS TO THE HOUSE OF COMMONS

REPORT TO THE HOUSE

Wednesday, April 30, 1986

The Standing Committee on Public Accounts has the honour to present its

TENTH REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1985 and, in particular, Chapter 6, the comprehensive audit of the Public Service Commission (the Commission).

2. The co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

3. The complexity of the rules and regulations governing staffing in the public service is a matter of great concern to your Committee. There is evidence that the methodology of staffing is cumbersome and unclear to managers. The Auditor General has referred to the development of a "contrived and curious science of personnel." In order for the system to meet the demands that are placed upon it, rules and regulations must be simplified and condensed. The Commission, which is responsible for the existing structure of rules, must play a leading role in this endeavor.

Recommendation

4. Your Committee recommends that the Commission develop an action plan for the simplification and condensation or rules and regulations on staffing and report its progress in doing so in writing to your Committee by September 30, 1986.

Monitoring of Departments' Staffing Activities

5. In accordance with its powers under the Public Service Employment Act, the Commission has delegated 98 per cent of its staffing responsibilities to departments. In view of the Commission's duty under the same Act to uphold the merit principle, your Committee considers that the high degree of delegation of authority for staffing must be complemented by an effective system of monitoring, to ensure that departments comply with the rules and policies set forward by the Commission.

6. The Auditor General informed your Committee that monitoring of departmental staffing activities by the Commission "was practically non-existent". The Commission agreed that its organization was not sufficient in this area, that it did not effectively integrate monitoring information gathered from departments and that it made inadequate use of this information. Your Committee recognized that the Commission is taking remedial measures to augment and centralize its monitoring activities. However, in view of the importance of the merit principle

and the need to safeguard its application in staffing actions, your Committee wishes to be assured that the Commission's monitoring activities are adequate for the task and fully comply with the recommendation of the Auditor General.

7. Affirmative action programs call for extensive and effective monitoring of departments' performance by the Commission. Your Committee was not satisfied with the evidence provided by the Commission in this regard. Progress in the hiring of women, visible minorities and the handicapped has been unacceptably slow and the monitoring procedures put in place by the Commission do not appear to be adequate for the task.

8. In order to expedite affirmative action for women, your Committee suggests that the Commission implement procedures to ensure a more sophisticated evaluation of volunteer experience in staffing actions.

Recommendations

9. Your Committee recommends that the Commission:

(a) **provide your Committee with a written report by September 30, 1986 on its progress in improving its monitoring of departmental staffing procedures;**

(b) **include in the aforementioned report evidence of consultations with the Auditor General to ensure full compliance with his recommendation that the Commission monitor adherence to its policies and procedures, as set forward in the Personnel Management Manual; and**

(c) **develop effective procedures to monitor and assess departments' progress in implementing affirmative action programs and report progress in this regard in writing by September 30, 1986.**

Simplification of Staffing Procedures

10. Your Committee is greatly concerned by the apparent inefficiency of the public service staffing system. In recent testimony, one government agency informed your Committee that one of the most serious obstacles to good management is the current staffing system. While recognizing that it is not always advantageous to management to staff a position quickly, your Committee noted that in certain cases where management requested staffing action, the system imposed significant delays. The Commission confirmed that the average time to staff a position ranged from 136 to 160 days. Your Committee considers that this is far too long.

11. Your Committee noted that, in one case, the time needed to staff a position had been cut to 44 days, as part of an administrative reform exercise involving the Commission and the Department of Agriculture. This was done in full compliance with the rules and policies of the Commission. This demonstrates that substantial improvements can be made. Your Committee considers that it is the responsibility of the Commission to ensure that similar improvements are made throughout the public service.

Recommendations

12. Your Committee recommends that the Commission:

(*a*) develop an action plan for the whole public service to significantly reduce the average amount of time required to staff a position, while taking care to maintain employees' legal rights; and

(*b*) report progress in this regard in writing to your Committee by September 30, 1986.

Workforce Adjustment Policy

13. Your Committee noted that where a function is eliminated within a department, a procedure known as reverse order of merit is used to determine which public servants will be laid off. This procedure is followed as part of the workforce adjustment policy. The Commission stated that it had not yet issued guidelines to departments and agencies governing the implementation of reverse order of merit, but was planning to do so. In view of continuing lay-offs within the public service, your Committee considers that there is an immediate need for the Commission to issue such guidelines. This will ensure equitable and consistent use of merit criteria in the release of surplus employees.

14. Your Committee wishes to ensure that up-to-date information on lay-offs within the public service is readily available to Parliamentarians. Although the Commission issues regular reports on this matter to management within the public service, the release of this information to outside parties such as unions and including Members of Parliament has been discretionary.

Recommendations

15. Your Committee recommends that:

(*a*) the Commission immediately issue guidelines to departments and agencies governing the implementation of reverse order of merit;

(*b*) the Government table quarterly reports on lay-offs within the public service;

(*c*) the Commission report back to your Committee with respect to recommendation (a) above by September 30, 1986; and

(*d*) the Government respond to recommendation (b) above in accordance with Standing Order 99(2).

Auditing

16. In an earlier report (the 17th Report, dated July 30, 1982, 1st Session, 32nd Parliament), your Committee reviewed the division of responsibilities between the Treasury

Board Secretariat and the Commission and recommended that these agencies "resolve problems of a lack of clarity and overlapping responsibilities". Your Committee now finds that these agencies have failed to implement this recommendation insofar as the Commission's auditing mandate is concerned. The division of responsibilities in this area is unclear. Powers claimed by the Commission in Part III of the Estimates, to audit all aspects of personnel management, were more extensive than allowed for by the Commission's agreement with the Secretariat defining the division of responsibilities between them. Your Committee expects the agencies to resolve this problem without further delay and ensure that a clear-cut division of responsibilities is established.

17. Your Committee noted that the Auditor General found various inadequacies in the Commission's program for the audit of staffing. Among the areas of concern were methodology, documentation, supervision and review of audit work and training of personnel. Such wide-ranging difficulties called for a major effort by the Commission to rectify the situation. The Commission informed your Committee that an effort was underway. However, in some areas such as project management and quality control, the Auditor General called into question the Commission's claims that remedial measure are functioning.

Recommendations

18. Your Committee recommends that the Commission:

(a) **clarify its staffing audit mandate and report its progress in so doing to your Committee in writing by September 30, 1986;**

(b) **report in writing to your Committee on its progress in implementing the Auditor General's recommendations in the area of auditing by September 30, 1986 and again by September 30, 1987; and**

(c) **include in the aforementioned reports evidence of consultations with the Auditor General to ensure full compliance with his recommendation that the Commission complete directives on staffing audit methods, scope and documentation, ensure adherence to these directives, review all audit files, introduce quality control measures and ensure adequate training for auditors.**

19. A copy of the relevant Minutes of Proceedings and Evidence (*issues Numbers 29, 30 and 32 which includes this report*) is tabled.

Respectfully submitted,

AIDEEN NICHOLSON
Chairman

REPORT TO THE HOUSE

Wednesday, May 7, 1986

The Standing Committee on Public Accounts has the honour to present its

ELEVENTH REPORT

1. In accordance with its permanent Order of Reference contained in the Permanent and Provisional Standing Orders of the House of Commons, your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1985 and, in particular, Chapter 10, the comprehensive audit of the Law Reform Commission (the Commission).

2. The co-operation of the witnesses who appeared before your Committee is acknowledged and appreciated.

Evaluating the Commission's Effectiveness

3. Your Committee recognises the important role the Commission plays as an independent research body that reviews continually and systematically the laws of Canada with a view to making recommendations to the Minister of Justice for improving, modernizing and reforming them. Your Committee recognises the influence that the Commission has had in recent years on legislation at both the federal and provincial levels, on law reform, on judicial decisions, and on changes in administrative law and other legal systems. Nevertheless your Committee urges the Commission to clarify its objectives and develop more meaningful performance indicators with which to measure the effectiveness of its research program.

Failure to Update or Revise the Research Program

4. Your Committee is concerned that the Commission did not see fit to update or revise its original research program commenced in 1972, and inform the Minister and Parliament from time to time of the changes and deviations in the work plan that had taken place subsequently. The Auditor General observed that the original research program was estimated to last only three years and that under the Law Reform Commission Act, the Commission is required to submit a detailed program and related resources as further specific areas of study are undertaken. Similarly, Parliament is to be kept informed on a timely basis about the progress of the research program. Contrary to the Commission's view, your Committee does not see the annual report as the appropriate authority for informing the Minister and Parliament of these directional changes.

5. Your Committee concludes that the failure, on the Commission's part, to keep the Minister and Parliament fully informed of the subsequent detailed changes in the research program was a serious breakdown in accountability and reporting and was not in accordance with the Act. Your Committee noted that the Commission is preparing a new work plan for September 1986.

Recommendation

6. Your Committee recommends that the Commission provide your Committee with a progress report by September 30, 1986 on the new work plan of the research program which will reflect the current areas of research, the estimated resource requirements, and the revised completion dates of projects.

Weaknesses in Project Management

7. The Auditor General brought to your Committee's attention weaknesses in the Commission's project management practices. Testimony before your Committee revealed that in the current accelerated Criminal Law Review, projects were not clearly defined, resources were not specified, and most projects did not meet their target dates. There was a noticeable lack of detailed work plans and an absence of guidelines or methodology for project managers. Your Committee is concerned over this lack of direction and control by the Commission of research projects and the significant costly delays in completing the first phase of the Criminal Law Review before October 1987. Witnesses from both the Commission and the Department of Justice assured your Committee that measures are being taken to respond to the Committee's concerns and that new project control procedures have been introduced.

Recommendation

8. Your Committee recommends that the Commission provide your Committee with a progress report by September 30, 1986 on the action taken by the Commission to improve its project management practices.

Contracting

9. Your Committee noted the Commission's lack of documented procedures and guidelines for hiring consultants under contract. The Commission has agreed to have a new improved system of contracting procedures in place by fiscal year 1986-87.

Recommendation

10. Your Committee recommends that the Auditor General provide your Committee with a progress report by September 30, 1986 on the measures taken by the Commission to improve its contracting procedures.

11. A copy of the relevant Minutes of Proceedings and Evidence (*Issue Numbers 28 and 32 which includes this report*) is tabled.

Respectfully submitted,

AIDEEN NICHOLSON
Chairman

REPORT TO THE HOUSE

Wednesday, May 28, 1986

The Standing Committee on Public Accounts has the honour to present its

TWELFTH REPORT

1. In accordance with its Orders of Reference dated Friday, June 21, 1985 and Tuesday, January 14, 1986 your Committee visited Washington, D.C., U.S.A. and London, United Kingdom and has agreed to the following report.

2. Your Committee travelled to Washington and London to observe and discuss the practices and procedures of its American and British counterparts with a view to improving its own methods of operation. While observing many interesting practices it was evident that many of these were unworkable in our committee system. Nevertheless, several procedures were observed which could assist your Committee in fulfilling its mandate. Some of these changes can be dealt with by your Committee itself, while others require the approval of the House.

Periodic Reporting

3. At present the *Auditor General Act* states, in part, that

"7(1) The Auditor General shall report annually to the House of Commons..."

Your Committee is very concerned about the timeliness of the audit findings contained in these annual reports. For example, comprehensive audits may be completed several months in advance of the tabling date. In view of the fact that these audits take up to two years to complete, certain of the findings may be out of date by the time that they are referred to your Committee.

4. In a report to the House tabled on June 13, 1984 (5th Report, 2nd Session, 32nd Parliament) your Committee recommended that the *Auditor General Act* be amended to permit more timely reports. In October 1985 a bill in the name of the Honourable Member for Prince Albert was presented. This matter was also raised in the House on March 4, 1985 by the Chairman of your Committee, the Honourable Member for Trinity.

5. Your Committee is of the opinion that the five or so *comprehensive audit* reports normally done each year should be tabled in the House on a completion-date basis. This would enable your Committee to scrutinize the Auditor General's comprehensive audit findings in a timely manner and make observations and recommendations as soon as possible after this type of audit is completed. In the U.K., the Comptroller and Auditor General makes frequent reports, which are immediately considered by the Public Accounts Committee. This practices was noted to be most workable and successful.

6. Other audit observations arising from the annual attest audit of departments, agencies and Crown corporations, together with preliminary findings from comprehensive audit work would continue to be reported on an annual basis.

Recommendation

7. Your Committee recommends that the Government immediately introduce a bill to amend the Auditor General Act, as follows (new wording underlined):

"7.(1) The Auditor General shall report at least annually to the House of Commons..." and that any consequential amendments be included.

Annual Debate on PAC Reports

8. Your Committee is of the opinion that greater attention should be given to Public Accounts Committee reports in order to put more emphasis on the accountability process. This may be achieved through a one-day debate in the House. Such a debate would allow for more effective follow-up on Committee reports. In addition, it is likely that Departments would pay more attention to the Committee's recommendations and take appropriate remedial action more quickly.

9. It is noted that in the United Kingdom one sitting day annually is set aside in the House to permit debate by all Members on the reports of the Public Accounts Committee. In Canada this practice is also followed in the legislatures of Ontario, Saskatchewan and the Yukon.

Recommendation

10. Your Committee recommends that the House designate one sitting day each calender year for the purpose of allowing debate on the reports of the Public Accounts Committee.

Parliamentary Scrutiny of the Office of the Auditor General

11. Your Committee noted that in the United Kingdom a statutory commission is charged with the responsibility of overseeing the operation of the National Audit Office. This includes the approval of the estimates and other matters pertaining to the operation and performance of the Audit Office. This commission reports to the House from time to time.

12. Your Committee is not entirely convinced that a similar commission is required in Canada. However, your Committee considers it inappropriate that although the Auditor General is a servant of Parliament he is subject to Treasury Board review in the preparation of his estimates like any other government department. At present his estimates are considered by the Standing Committee on Government Operations, which has no other involvement with his Office. In view of your Committee's familiarity with and understanding of the Auditor General's work, it considers that any matter relating to the Office of the Auditor General should

be referred to the Public Accounts Committee, including the estimates. This would permit your Committee to have a more significant role in the operation and scrutiny of the Office of the Auditor General.

Recommendations

13. Your Committee recommends that all matters relating to the Office of the Auditor General, including the estimates, be referred to the Standing Committee on Public Accounts.

14. Your Committee requests that the Government respond to the recommendations contained in this report in accordance with S.O. 99(2).

15. A copy of the relevant Minutes of Proceedings and Evidence (*Issue No. 33 which includes this report*) is tabled.

Respectfully submitted,

AIDEEN NICHOLSON
Chairman

The Thirteenth Report related to Committee business.

REPORT TO THE HOUSE

Thursday, June 26, 1986

The Standing Committee on Public Accounts has the honour to present its

FOURTEENTH REPORT

I. In accordance with its permanent Order of Reference contained in the Permanent and provisional Standing Orders of the House of Commons your Committee has considered the Report of the Auditor General to the House of Commons for the fiscal year ended March 31, 1984 and, in particular, paragraphs 3.34 to 3.49, audit observations relating to the Scientific Research and Development Tax Credit (SRTC) Program of the Department of Finance (the Department).

2. Your Committee noted that the Scientific Research and Development Tax Credit Program was proposed in a budget discussion paper in April, 1983 and was implemented by amendments to the Income Tax Act in January, 1984. The program was subjected to a moratorium in October, 1984 and was terminated in the Budget of May, 1985.

3. Your Committee wishes to emphasize that certain of the research projects supported by this program were legitimate additions to research and development (R & D) in Canada. In some cases new products and new technologies have been developed.

4. In the opinion of your Committee, the Department of Finance was negligent in its management of the SRTC program in the following respects:

(a) unsound economic analysis of the costs and impact of the program;

(b) a badly managed, incomplete consultation process;

(c) failure to foresee the negative effects of the quick flip;

(d) inadequate definition of and controls over qualifying research activity;

(e) the failure to disclose the quick flip in the budget consultation paper;

(f) inability to recognize danger signs and missed opportunities to stop the SRTC program; and

(g) lack of proper evaluation procedures.

5. The SRTC program was intended to provide funds to research companies in Canada through the tax system. Companies did not have to be in a taxable position to qualify. They could notify Revenue Canada of their plans to carry out research activities (termed a "designation") and, on the basis of these designations, issue securities to investors which conveyed a tax credit equal to 50 per cent of the value of the security. For investors with tax

liabilities, these credits were immediately usable. To ensure that research was carried out, companies become liable for a tax equal to the tax credits, which could be reduced or eliminated if qualifying research had been undertaken within a specified time period.

6. It is an understatement to say that the SRTC program has not performed as intended. On the basis of the latest data presented to your Committee, designations under the SRTC program have totalled $7 billion. Excluding double counting, up to $5.6 billion in research activity would be expected with this value of designations. However, because of a procedure known as the quick flip, research companies have a collective shortfall of $2.9 billion in funds needed to carry out research and the Crown faces uncollectible taxes in excess of $900 million at last count. In addition, the Auditor General has estimated a $350 million cost of delivering the program.

7. The SRTC program has emerged as a costly boondoggle, a tax expenditure that in effect became a tax loophole. Your Committee held four hearings, over the course of a one-year period, and has examined how the SRTC program came to be adopted and why it went wrong. In order to deal with the issues of the SRTC episode, your Committee will comment on each of the three distinct phases of the program: the preparatory phase, focusing on the consultation process prior to the adoption of the legislation; the legislative phase, dealing with program delivery through the tax system; and the response phase, when data became available and a mechanism was needed to quickly alter a program gone wrong.

The Preparatory Phase

8. Your Committee noted that the SRTC was introduced through a consultation process managed by officials in the Department of Finance. This involved consultations with R and D performing companies before and after the tabling of a consultation paper that was part of the April 1983 budget.

9. The Department informed your Committee that the initial stage of consultations formed the basis for an evaluation of existing R and D tax measures. The conclusion reached was that these tax incentives were largely unusable by non-taxable research companies. The Department therefore sought to design a tax program to benefit these companies.

10. The fundamental feature of the SRTC was the prefunding concept, the making available of funds through the tax system before research had been carried out. Your Committee considers that this approach was not suitable for a tax measure, for the simple reason that it precluded effective controls prior to the disbursement of public funds.

Recommendation

11. Your Committee recommends that the Government avoid the use of prefunding in tax expenditure programs.

12. With respect to the formal consultation process that started with the tabling of the consultation paper, the Department stated that it sought the views of three groups: large and small R and D performers and various trade associations. Your Committee heard no evidence that accountants, tax lawyers, investment dealers and other experts from the financial community were consulted. In view of the objective of the SRTC program, to promote investment in R and D, your Committee considers this to have been a serious deficiency.

13. Your Committee was left with the impression that the consultation process was neither well-planned nor comprehensive. The Department was negligent in that it did not properly test the SRTC concept through this process. For example, the consultation paper contained a cost estimate based on the extent of non-taxable research companies' expenditures on R and D. The consultations which ensued did not test this cost concept with the investment community. As a result, the huge demand for SRTCs was completely unanticipated.

Recommendation

14. Your Committee recommends that in future the Minister of Finance table in Parliament a document outlining the results of any consultation process involving proposed tax expenditures prior to the passage of legislation giving effect to the tax expenditure in question.

The Legislative Phase

15. Your Committee noted that one of the principles set forward in the consultation paper was that "tax incentives should not be used, or set at a level, to promote R & D activities that do not conform to sound business practice." It was the task of officials in the Department of Finance to ensure that the SRTC was implemented with adequate controls, so that the program would not be over-generous and would not encourage expenditures on R and D solely as a means of tax avoidance.

16. As the Auditor General has pointed out, the program delivery system for a tax expenditure such as the SRTC is the legislation which put it into effect. The Department of Finance needed to ensure that the legislation included basic procedures to safeguard public funds.

17. Your Committee has the following concerns with respect to the legislation which implemented the SRTC program:

(a) the allowance of the quick flip procedure; and

(b) inadequate definition of and controls over qualifying research activity.

18. In a quick flip transaction, the investor immediately redeemed the security conveying the tax credit for an amount generally equal to 60 per cent of his investment in the research company. With the 50 per cent tax credit in hand, the investor made a quick profit

and walked away from the research company. If the research company did not have access to secondary financing, it was left with a substantial shortfall in the funds required to be expended on qualifying research. Revenue Canada has estimated that two-thirds of the companies engaged in quick flip transactions did not have access to secondary financing.

19. Your Committee noted that most of the transactions (74 per cent) under the SRTC program involved quick flips. The effects of the quick flip were:

(a) to encourage abuse by providing a unique kind of government-guaranteed risk-free security;

(b) to weaken the major control feature of the program, the offsetting tax liability, by reducing the funds available for qualifying research; and

(c) to create bad debts for the Crown in situations where research companies could not meet their tax obligations.

20. The Department informed your Committee that the quick flip was clearly contemplated from the outset of the SRTC program. It was an attempt to put money in the hands of R and D companies with as few bureaucratic restrictions as possible. However, the Department has also testified that it did not fully see the connection between quick flips and the serious shortfall in funding that so undermined the SRTC program.

21. Your Committee noted that the quick flip procedure was not outlined in the consultation paper. The Department has testified that the first public mention of this procedure and in effect, the Department's approval of it, was in a press release in January, 1984 after the passage of the legislation. In other words, the quick flip was introduced via an interpretation of the legislation. Your Committee considers this omission a serious failing of the consultation process and, indeed, of the process by which Parliament approved the legislative changes in question.

Recommendation

22. Your Committee recommends that in the future the Minister of Finance report to Parliament any changes in the interpretation of tax expenditure legislation.

23. Apart from the general definition of research in the Income Tax Act, your Committee noted that the SRTC program was implemented without operational guidelines defining legitimate research activity. Revenue Canada testified that the documentation called for in the designation process was merely a plan or an outline of planned research activity. In short, the design of the SRTC program did not call for verifiable, hard information based on clear guidelines as to what did and did not constitute bona fide research activity. The Department of Finance also stated that officials were responsible for not recommending to their Minister better controls over the quality of research being undertaken.

24. Revenue Canada testified in March of this year that clear guidelines on the definition of scientific research were then being developed. Your Committee likens this sort of program implementation to locking the barn door after the horse has bolted. Clearly the design of the SRTC program was deficient. Your Committee also considers that officials failed to provide accurate and complete advice to their Minister.

Recommendation

25. Your Committee deplores the fact that the Department of Finance did not have adequate controls in place and recommends urgent action to ensure that adequate controls are in place in order to safeguard public funds in any future tax expenditure program.

The Response Phase

26. Revenue Canada testified that the earliest data from SRTC tax designations was available 90 days after the passage of the legislation. Shortly thereafter, Revenue Canada formulated its concerns about the shortfall in research funds and the dubious nature of many of the research proposals. In June, 1984 in consultation with the Department of Finance, Revenue Canada implemented a monitoring program, the results of which led to the October 1984 moratorium and the eventual cancellation of the SRTC in the May 1985 Budget. Revenue Canada also testified that all SRTC tax returns would be audited when they were received. It was also noted that there is a significant delay, up to six months after the end of the financial year of the company making the SRTC designation, before tax returns are required to be filed and therefore available for audit. Only after these audits are completed will the full costs of the SRTC program be known.

27. Revenue Canada stated that the time frame of their response was the earliest possible, given the nature of a tax program. Your Committee disagrees. Certain important danger signals were in evidence before, during and after the legislative phase of the SRTC program. In addition, the failure of the Department of Finance to establish an evaluation framework from the outset of the SRTC program seriously imperilled the ability of the Department to be aware of and to respond to problems as they developed.

28. Your Committee considers that the volume of the demand for advance tax rulings and the sources of this demand were, in themselves, sufficient warning that the SRTC was not developing as anticipated. Revenue Canada indicated that upwards of 50 requests for tax rulings were received prior to the introduction of the legislation in January 1984. In comparable tax expenditure programs. Revenue Canada stated that no more than a handful of such requests would normally be received. In a single transaction based on such a tax ruling, one company, the subsidiary of a major oil company, made a profit of $25 million in funds entirely derived for the tax system. The knowledge that such transactions were contemplated should have called into question the Department of Finance's estimate of a $100 million net annual cost of the SRTC program. More to the point, it should have called into question the whole SRTC proposal.

29. Your Committee noted that number of other danger signs were ignored by the Department of Finance. In January 1984, before a Senate Committee, the Department was warned about the potential cost of the SRTC program. It has also become known that officials from provincial finance departments made their concerns known early in the life of the SRTC program. In one case, an RCMP investigation was suggested, to no avail.

30. Your Committee is also concerned by the costly delay in decision-making, from the period in June 1984, when monitoring was implemented and the problems known, to the October 1984 moratorium. In view of the testimony from officials that there was "a continuous dialogue at the ministerial level" at the time of the imposition of the monitoring program on June 5, 1984, your Committee considers that an important opportunity to stop the SRTC program was missed at that time.

31. Your Committee noted that from the time of the inception of the SRTC program Parliament was not provided with a progress report.

Recommendations

32. Your Committee recommends that the Minister of Finance:

***(a)* table an annual report stating the objectives, known information on progress towards these objectives, and estimated costs of every major tax expenditure program; and**

***(b)* develop a mechanism to alter quickly a tax expenditure program where significant problems have been encountered.**

33. With respect to evaluation procedures, the Auditor General informed your Committee that the Department of Finance did not have an appropriate program evaluation capability. The Department had not established an independent unit responsible for systematic evaluation procedures. The Auditor General also informed your Committee that the SRTC program was amenable to program evaluation. Your Committee is not satisfied with the Department's ad hoc approach to program evaluation.

Recommendations

34. Your Committee recommends that the Department:

***(a)* develop a comprehensive program evaluation capability, as described in the Comptroller General's "Guide to the Program Evaluation Function"; and**

***(b)* ensure that all tax expenditure programs are subject to program evaluation.**

35. Your Committee requests that the Government provide a comprehensive response to this report in accordance with S.O. 99(2).

36. A copy of the relevant Minutes of Proceedings and Evidence (*Issue Nos. 18, 19, 31, 33 and 3 which includes this report*) is tabled.

Respectfully submitted,

AIDEEN NICHOLSON
Chairman

APPENDIX D

REPORT ON QUARTERLY REPORTS

REPORT ON THE AUDIT OF QUARTERLY REPORTS ON CROWN CORPORATIONS TABLED BY THE PRESIDENT OF THE TREASURY BOARD

As required by section 153.1 (2) of Part XII of the Financial Administration Act, I have examined the Quarterly Reports to Parliament on Crown corporations tabled by the President of the Treasury Board for the three quarters indicated below:

	Tabled in Parliament	
Quarter Ended	**House of Commons**	**Senate**
September 30, 1985	November 18, 1985	November 26, 1985
December 31, 1985	February 26, 1986	March 4, 1986
March 31, 1986	May 14, 1986	May 27, 1986

This is my second report on these Quarterly Reports. The reports contain information about the timing of tabling by the appropriate Ministers, of summaries (and amendments to them) of Crown corporations' corporate plans, operating budgets, capital budgets and annual reports.

My examination included a review of the systems and procedures used by the Treasury Board to monitor the timing of tabling the summaries and annual reports in each House of Parliament and a verification of the information contained in each of the Quarterly Reports.

These three Quarterly Reports were laid before each House of Parliament in accordance with section 153.1 (1) and (3) of the Financial Administration Act and, based on my examination, I have concluded that the information contained in them is accurate and complete.

Kenneth M. Dye

Kenneth M. Dye, F.C.A.
Auditor General of Canada